Supreme Court, U.S.
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No. 03-2

In the

Supreme Court of the United States

OXFORD ASSET MANAGEMENT, LTD., and SUSMAN & WATKINS,

Petitioners,

v.

MICHAEL JAHARIS, DANIEL M. BELL, DUNCAN H. COCROFT, JUAN F. RODRIGUEZ, ROBERT E. BALDINI, JOHN BRADEMAS, STEVE JAHARIS, LOUIS LASAGNA, MARK NOVITCH, FREDERICK B. WHITTEMORE, KOS PHARMACEUTICALS, INC., COWEN & COMPANY, DONALDSON LUFKIN & JENRETTE, SALOMON SMITH BARNEY HOLDINGS, INC., SBC WARBURG, DILLON, READ, INC., individually and as representatives of THE CLASS OF UNDERWRITER DEFENDANTS,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Whether, notwithstanding the "notice pleading" standard set forth in Fed. R. Civ. P. 8(a), a heightened "fact pleading" standard applies to claims under §§ 11 and 12(a)(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k and 77l(a)(2), even where those claims are based on strict liability and expressly disavow any reliance on fraud.

II. Whether, in an action under §§ 11 and 12(a)(2) of the 1933 Act, a court may determine as a matter of law that facts which the court acknowledges to be material to investors in a securities offering are nonetheless not subject to required disclosure in the securities offering documents.

III. Whether sanctions may be imposed against a §§ 11 and 12(a)(2) plaintiff, and its counsel, for failing to meet a heightened "fact pleading" standard that is not only incorrect as a matter of law, but also was applied for the first time in this case and is contrary to the law of other circuits.

LIST OF PARTIES

The Eleventh Circuit ruled in this case after consolidating Oxford's two appeals: (1) Oxford's appeal of the district court's dismissal of the complaint (No. 99-11690); and (2) Oxford's appeal of the district court's order sanctioning plaintiffs and their counsel (No. 00-13220). The parties to those proceedings were as follows:

No. 99-11690:

Oxford Asset Management, Ltd. was Plaintiff-Appellant.

Michael Jaharis, Daniel M. Bell, Duncan H. Cocroft, Juan F. Rodriguez, Robert E. Baldini, John Brademas, Steve Jaharis, Louis Lasagna, Mark Novitch, Frederick B. Wittemore, Kos Pharmaceuticals, Inc., Cowen & Company, Donaldson Lufkin & Jenrette, Salomon Smith Barney Holdings, Inc., SBC Warburg, Dillon, Read, Inc. were Defendants-Appellees.

No. 00-13220:

Oxford Asset Management, Ltd. and Lowey Dannenberg & Knapp, P.C. Profit-Sharing Plan, a/k/a Lowey Dannenberg, Bemporad & Selinger P.C. Profit-Sharing Plan were Plaintiffs-Appellants. Arthur T. Susman, Charles R. Watkins, Robert J. Emanuel, and Susman & Watkins were additional Appellants.

Defendants-Appellees were those named in No. 99-11690.

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Petitioners state that Oxford Asset Management, Ltd. and Susman & Watkins have no parent corporations and that no publicly held corporation holds 10% or more of the stock in either Oxford Asset Management, Ltd. or Susman & Watkins.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Oxford Asset Management, Ltd. ("Oxford") and Susman & Watkins (the "Susman Firm") petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 1-27) is reported at 297 F.3d 1182. The order of the court of appeals on denial of the petition for rehearing (App. 77-78) is unreported. The orders of the district court dismissing the complaint with prejudice (App. 28-60), granting the motion for sanctions (App. 61-73), and assessing fees (App. 74-76) are all unreported.[1]

JURISDICTION

The judgment of the court of appeals was entered on July 16, 2002. A timely petition for rehearing *en banc* was denied on March 25, 2003 (App. 77-78). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED

Pursuant to Rule 14.1(f), citations to the statutes and rules relevant to this case are set out below. The full text for each appears in Appendix 79-123.

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[1] Unless otherwise indicated, all citations are to the attached Appendix ("App. __.") or to the Record originally filed with the court of appeals in this case ("R. __.").

- Sections 11, 12(a)(2), and 15 of the Securities Act of 1933, as amended, 15 U.S.C. § 77k, 77l(a)(2), and 77(o) (App. 79-87.)
- Sections 101(a) and 101(b) of Pub. L. 104-67, the Private Securities Litigation Reform Act (PSLRA), 15 U.S.C. §§ 77z-1, and 78u-4 (App. 88-118.)
- Rules 8(a)(2), 9(b) and 11 of the Federal Rules of Civil Procedure, Fed. R. Civ. P. 8(a)(2), 9(b), and 11 (App. 119-123.)

STATEMENT

The United States District Court for the Southern District of Florida dismissed with prejudice Oxford's complaint, which, among other things, sought relief under §§ 11 and 12(a)(2) of the Securities Act of 1933 against Kos Pharmaceuticals Inc. ("Kos") and others. The complaint alleged that Kos made several specific material misrepresentations and omissions in the prospectus and registration statement filed in connection with its October 1997 secondary offering of common stock (the "Secondary Offering"). The district court dismissed the complaint, finding that the allegations lacked sufficient factual particularity under a heightened pleading standard which it deemed applicable, and then sanctioned Oxford and its counsel over $520,000 for bringing the complaint. The Eleventh Circuit affirmed the dismissal of the complaint and the award of sanctions, virtually in its entirety.[2]

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[2] Sections 11 and 12(a)(2) of the Securities Act of 1933 provide a cause of action to purchasers of securities against the issuer or other seller where a registration statement (§ 11) or prospectus (§ 12(a)(2)) contains a material misstatement or omission. (App. 79-86.)

The decision below conflicts with prior decisions of other courts of appeals on three important questions of federal law that significantly impact a purchaser's ability to seek redress under §§ 11 and 12(a)(2) of the 1933 Act. *First*, the Eleventh Circuit dismissed Oxford's §§ 11 and 12(a)(2) claims, which did not involve any allegation of fraud, by applying a heightened pleading standard that required "fact" rather than "notice" pleading. *Second*, the Eleventh Circuit held that Kos's omitted prescription data was "material," but nonetheless immune from mandatory disclosure, thereby abrogating the "full disclosure" standard for issuer liability under §§ 11 and 12(a)(2). *Finally*, the Eleventh Circuit levied sanctions against Oxford and its counsel for failing to plead "facts" in its complaint, despite the novel, erroneous nature of the pleading standard against which the court measured the adequacy of the complaint.

A. The Secondary Offering and the Immediate Collapse of Kos's Stock Price.

Kos is a publicly traded pharmaceutical company. (App. 2.) During the relevant period, Kos had only one product: a prescription cholesterol-management drug called Niaspan. On October 21, 1997, Kos filed an SEC registration statement and prospectus for the Secondary Offering. (App. 3.) Kos set the offering price at $42.75 per share. (*Id.*) As part of the Secondary Offering, Kos and two of its top executives sold 3.65 million shares for nearly $155 million during a four-day period ending October 24, 1997. (*Id.*) Oxford purchased 1000 shares of Kos Stock. (R. 1 ¶ 10.)

On November 12, 1997, just 13 trading days after the close of the Secondary Offering, a Salomon Brothers analyst, Robert Uhl, released a report (the "Uhl Report"), which showed, based on prescription data largely collected (but not disclosed) before the Secondary Offering, that Niaspan was a commercial failure. (App. 3; R.1, ¶ 59.)

Salomon Brothers was one of the Secondary Offering's underwriters.

The previously undisclosed data showed that only 708 Niaspan prescriptions were filled in the first eight weeks of Niaspan sales (a period ending on October 31, 1999); that figure was well below the number of prescriptions needed during that period (5,000) to justify the earnings estimates contained in Kos's prospectus. (*Id.*) According to the Uhl Report, the first eight weeks of prescription data is generally considered to be a reliable indicator of future commercial performance. (App. 3.)

Uhl slashed in half his Kos earnings estimate and changed the rating of the stock from "buy" to "hold." (*Id.*) The market reaction was immediate: the Kos stock plummeted nearly 50% to $16-9/16 on the day the Uhl Report was released. (*Id.*) Thus, within a few days, the market value of the shares sold in the Secondary Offering had declined from $155 million to $60 million—a loss to investors of nearly $100 million.

Following the dramatic collapse of Kos's stock price, Oxford consulted the Susman Firm concerning its loss. A seven-month investigation followed. (R.67, Ex. A, ¶ 3.) The Susman Firm reviewed Kos's SEC filings, its press releases regarding Niaspan, the publicly available facts surrounding the Secondary Offering, and available securities analyst reports. (*Id.* at ¶¶ 4-7.) To evaluate Niaspan itself, the Susman Firm reviewed nine medical studies of the drug and its active ingredient, niacin, and consulted two medical experts experienced in pharmacological studies and the treatment of lipid disorders. (*Id.* at ¶¶ 4-9, 12-13; R.24, Ex. A.) Based on the available data and expert analyses, Oxford's counsel concluded that Oxford had actionable claims against Kos and others under both the 1933 Act and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78(j), 78(t)(a).

B. District Court Proceedings.

On August 10, 1998, Oxford filed a securities class action complaint in the United States District Court for the Northern District of Illinois against Kos, certain of its officers and directors, and the lead underwriters. (App. 5.)[3] The case was later transferred to the Southern District of Florida. Jurisdiction in the district court was based on 28 U.S.C. § 1331 because the case involved a federal question.

Among other statutory and common law claims, Oxford's complaint asserted claims under §§ 11, 12(a)(2), and 15 of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77l(a)(2), and 77(o).[4] The complaint alleged that Kos's offering materials contained material misstatements and omissions regarding the prescription history, efficacy, and safety of Niaspan. It expressly stated that Oxford's 1933 Act claims did not rest on fraud. (R. 1 ¶¶ 66, 77, 85.).

Oxford pleaded that Kos's offering materials contained three specific categories of material misstatements or omissions:

(a) Kos's prospectus omitted material historical prescription data (reflected in the Uhl Report) showing that the level of Niaspan prescriptions could not support the prospectus's earnings estimates;

(b) Kos misrepresented Niaspan's efficacy by falsely stating that Niaspan could boost "good" HDL cholesterol "by up to 32%"; and

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[3] A profit-sharing plan was also a plaintiff in the district court. The plan joined in Oxford's appeal of the sanctions order, but is not a petitioner here. (*See* App. 5.)

[4] Plaintiffs also alleged violations of §§ 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78(j) and 78(t)(a), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. Those claims are no longer involved in this case.

(c) Kos misstated material information regarding the safety of Niaspan, both by omitting to disclose that Niaspan was intolerable at the effective dose of 2000mg, and by basing safety claims on defective clinical trials that excluded pre-menopausal women, who have lower tolerances to the drug's side effects.

On May 19, 1999, the district court granted defendants' motion to dismiss Oxford's complaint. (App. 6.) The district court held that: (1) Kos's omission of its first eight weeks of prescription data was immaterial as a matter of law, and could not therefore support a claim under §§ 11 and 12(a)(2) (App. 49-53); and (2) Oxford had not pleaded sufficient facts to support its allegations of material misrepresentations regarding the safety, efficacy, tolerability, and sales volume of Niaspan. (App. 42-49.) The district court stated that Oxford's claims were "conclusory" and "factually insufficient," and it dismissed Oxford's complaint with prejudice, holding that "the deficiencies in Plaintiff's claims cannot be cured." (App. 59.)

Defendants thereafter moved for sanctions under the PSLRA and Fed. R. Civ. P. 11. On January 31, 2000, without conducting a hearing, the district court granted defendants' motion and levied sanctions against plaintiffs and their counsel for filing the complaint. (App. 61-73.) The district court found that Oxford's legal arguments were not frivolous, and that Oxford's counsel had conducted an adequate investigation before filing the complaint. (App. 67.) However, the court determined that plaintiffs and their counsel should be sanctioned based on "factual deficiencies" in the complaint: Oxford's "claims were objectively frivolous and counsel for Plaintiffs should have been aware . . . that it was factually deficient." (App. 68.) The court further held that "all of Plaintiff's claims were devoid of evidentiary support," and it ordered that plaintiffs and their counsel pay all of defendants' attorneys

fees and costs (App. 73), which the court later assessed at $502,576.82. (App. 74-76.)[5]

C. Court of Appeals Proceedings.

On appeal, the Eleventh Circuit affirmed both the dismissal with prejudice of Oxford's §§ 11 and 12(a)(2) claims and the half-million dollar sanction which the district court levied against Oxford and its counsel. First, the Eleventh Circuit articulated an unusual standard for determining an issuer's liability under §§ 11 and 12(a)(2). The court specifically acknowledged that the withheld prescription data was "material," but nonetheless held that Kos had no duty to disclose it. (App. 11-16.) Contrary to the law of other circuits, the Eleventh Circuit held that § 11 does not create a general duty to disclose all known material factual information. According to the court, "requir[ing] *all* material information to appear in the prospectus would . . . result in registrants burying the shareholders in an avalanche of trivial information." (App. 12 (emphasis original).) The court further stated that Kos had no duty to disclose the prescription data because the prospectus was not misleading. (App. 16.)

Second, the Eleventh Circuit accepted Kos's contention that the sufficiency of Oxford's complaint should be determined under a "fact pleading" standard. (App. 16-20.) Thus, the court of appeals upheld the dismissal of each of Oxford's claims regarding the safety and efficacy of Niaspan on the ground that the complaint contained insufficiently particularized factual detail. (*Id.*) As to the efficacy claim, the Eleventh Circuit held that Oxford failed "to allege facts

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[5] The district court subsequently raised the sanction to $520,091.82, ordering plaintiffs' counsel to pay $260,045.91, with plaintiffs paying the remainder.

that support the conclusion that the 32% [increase in HDL cholesterol] claim is false." (App. 17.) Similarly, the safety claim was deemed factually insufficient because (a) Oxford "does not plead the existence of facts that would support its allegation that Niaspan elevates liver enzymes to an intolerable level [and] [n]o studies are referred to, no specific facts are pleaded that indicate any basis for Oxford's bald assertions," and (b) Oxford's complaint "fails to plead any factual basis" for its claim that the Prospectus was based on "skewed" clinical trials. (App. 18-19.) The Eleventh Circuit did not identify the source of the heightened pleading standard it applied, and gave no explanation for choosing it.

Third, the Eleventh Circuit substantially affirmed the district court's decision to sanction Oxford and its counsel for filing the complaint. (App. 20-26.) The Eleventh Circuit vacated the order and remanded for further proceedings, holding that the sanctions award should be reduced slightly because Kos was not entitled to fees with respect to Oxford's claim based on omission of the prescription data. (App. 26.) However, the Eleventh Circuit upheld the rest of the sanctions award, holding that the district court did not abuse its discretion in concluding that Oxford's other claims, all dismissed at the motion stage, "lack[ed] evidentiary support." (App. 22.)

A timely petition for rehearing *en banc* was denied on March 25, 2003. (App. 77-78.)

REASONS FOR GRANTING THE PETITION

In holding that Oxford's §§ 11 and 12(a)(2) claims should be dismissed for failure to plead specific supporting facts—and then affirming a half-million dollar sanction against Oxford and its lawyers for failing to meet that heightened pleading standard—the Eleventh Circuit

decided fundamental questions of federal securities law, arising in virtually every securities action brought under those sections. The Eleventh Circuit did so in a way that imposes substantial additional burdens on those who would enforce the securities laws. The decision below also conflicts with decisions of other circuits concerning both the pleading standard for §§ 11 and 12(a)(2) claims and the substantive rules for determining an issuer's liability under those sections, as well as with bedrock principles of federal pleading law previously established by this Court. Similarly, the imposition of a half-million dollar sanction in this case is unprecedented, departs from the ordinary course of judicial proceedings, and is manifestly unjust. The decision below clearly warrants review by this Court.

1. The Eleventh Circuit's unambiguous, albeit unexplained, application of a heightened "fact pleading" standard to Oxford's §11 and §12(a)(2) claims conflicts with decisions of several courts of appeals. *First*, the decision below is consistent with decisions in the Third and Ninth Circuits, but conflicts with decisions of the Eighth and Fifth Circuits, which specifically hold that plaintiffs bringing § 11 and § 12(a)(2) claims in similar circumstances need only meet the "notice pleading" standard of Fed. R. Civ. P. 8(a). In *In re NationsMart Corp. Securities Litigation*, 130 F.3d 309, 314 (8th Cir. 1997), the Eighth Circuit specifically held that § 11 and § 12(a)(2) claims need not satisfy the Fed. R. Civ. P. 9(b) particularity requirement for pleading fraud under *any* circumstances because fraud is not an element of those actions. Similarly, in *Lone Star Ladies Investment Club v. Schlotzsky's Inc.*, 238 F.3d 363, 369 (5th Cir. 2001), the Fifth Circuit held that the Rule 8 standard applies if, as here, the plaintiff's § 11 and § 12(a)(2) claims expressly disclaim any reliance on fraud. *Second*, to whatever extent the Eleventh Circuit may have thought that a heightened

pleading standard was required by the PSLRA, the decision below is not only contrary to the plain language of that statute, but is also inconsistent with the Eighth Circuit's decision in *Romine v. Acxiom Corp.*, 296 F.3d 701, 704-05 (8th Cir. 2002), which held that the PSLRA pleading standard does not apply to §§ 11 and 12(a)(2) claims. *Finally*, the Eleventh Circuit's decision, which imposes a pleading standard more arduous than that mandated by Congress, exceeds the power of the judicial branch, as this Court has held in other circumstances. *See, e.g.*, *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993) (a requirement of greater specificity for particular claims "is a result that must be obtained by the process of amending the Federal Rules, and not by judicial interpretation").

2. The Eleventh Circuit's decision warrants review for a second reason. By holding that §§ 11 and 12(a)(2) do not require the disclosure of all material information in securities offering documents, the Eleventh Circuit decided an important question of law, which is central to the proper enforcement of the securities laws, in a way that is erroneous and conflicts directly with the law of the Second Circuit. To hold, as the Eleventh Circuit did, that information may be material, but nonetheless, not subject to mandatory disclosure, is a logical impossibility. Under §§ 11 and 12(a)(2), as the Second Circuit has held, *all* material information must be disclosed; an issuer's liability for withholding material information is "absolute." *Kronfeld v. Trans World Airlines, Inc.*, 832 F.2d 726, 730 n.8 (2d Cir. 1987), *citing Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983).

3. The decision below also warrants review with respect to the half-million dollar sanction that was levied against Oxford and its counsel. In this case, the court of appeals applied a new pleading standard for §§ 11 and 12(a)(2)

claims in the Eleventh Circuit. That standard is both contrary to the law of other circuits and wrong. A party cannot be sanctioned for failing to comply with an erroneous legal standard. Moreover, even if the standard were not itself erroneous, at least one other circuit has held that sanctions cannot be imposed where the law is unsettled. As the Seventh Circuit held in *Hartmarx Corp. v. Abboud*, 326 F.3d 862, 868 (7th Cir. 2003), a party cannot be sanctioned for guessing wrong on how a particular court will decide an unsettled question of law. For a half-million dollar sanction to be assessed against a party and its attorneys in such circumstances so far departs from the normal course of judicial proceedings as to warrant review for that reason alone.

I. Whether A "Fact Pleading" Standard Should Be Applied To § 11 and § 12(a)(2) Claims Is An Important Question of Federal Law Upon Which The Courts of Appeals Are Divided.

Although fraud is not an element of a § 11 or § 12(a)(2) claim, the courts of appeals are deeply divided on whether a heightened pleading standard applies to such claims. Five circuits have now addressed the issue. The Eighth Circuit has correctly determined that such claims need meet only the "notice pleading" standard of Fed. R. Civ. P. 8(a). The Third and Ninth Circuits have held that the heightened Fed. R. Civ. P. 9(b) standard—which requires that allegations of fraud be pleaded with factual particularity—applies when the claim "sounds in fraud." The Fifth Circuit has held that § 11 claims should be evaulated under the Rule 8 standard if the claimant disavows that its claim is based on fraud. The decision below, which applies a heightened "fact pleading" standard to Oxford's § 11 and § 12(a)(2) claims, notwithstanding Oxford's expressed disavowal of any fraud-based theory, adds further confusion to this division, which warrants resolution by this Court.

1. Absent a federal procedural rule or statutory provision, complaints in federal court need only meet the "notice pleading" requirement of Fed. R. Civ. P. 8(a); that is, the complaint need contain only a "short and plain statement of the claim showing that the pleader is entitled to relief." *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993). The purpose of a complaint in the federal system is to "give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Conley v. Gibson,* 355 U.S. 41, 47 (1957). "[T]he Federal Rules of Civil Procedure *do not require a claimant to set out in detail the facts on which he bases his claim.*" *Id.* (emphasis added). Consequently, "[a] complaint that complies with the Rules of Civil Procedure cannot be dismissed on the ground that it is conclusory or fails to allege facts." *Higgs v. Carver*, 286 F.3d 437, 439 (7th Cir. 2002).

In this case, the Eleventh Circuit clearly demanded a level of factual specificity beyond the established requirements of notice pleading. *See Annual Review of Federal Securities Litigation*, 58 Business Lawyer 747, 869-73 (2003) (criticizing the heightened pleading standard applied by the Eleventh Circuit in this case). The Eleventh Circuit affirmed dismissal of Oxford's claim regarding Niaspan's effectiveness "for failure to allege facts that support the conclusion." (App. 17.) The court of appeals affirmed dismissal of Oxford's claims regarding Niaspan's safety, holding that "[n]o studies are referred to, no specific facts are pleaded that indicate any basis for Oxford's bald assertions." (App. 18.) The court of appeals also held that "Oxford's complaint fails to plead any factual basis" for its allegation that clinical trials of Niaspan skewed safety data, and further held that "the complaint does not allege any facts that support the conclusion" that the prospectus misstated sales figures. (App. 19.) In sum, the Eleventh

Circuit expressly required Oxford to plead particularized facts to support its §§ 11 and 12(a)(2) claims (App. 16-20), and it affirmed dismissal of those claims for failure to meet that heightened standard. (*Id.*)

Although the circuits are divided on the proper pleading standard for §§ 11 and 12(a)(2) claims, neither Rule 9(b), the PSLRA, nor any other possible exception to Rule 8(a) provides any basis for imposing a heightened pleading standard for such claims.

2. The Eleventh Circuit's unambiguous application of a heightened "fact pleading" standard conflicts with prior decisions of the Eighth and Fifth Circuits. In *In re NationsMart Corp. Securities Litigation*, 130 F.3d 309 (8th Cir. 1997), plaintiffs alleged that NationsMart's prospectus failed to disclose material facts regarding a downtrend in business and an increase in operating costs. *Id.* at 314. Applying a heightened pleading standard, the district court dismissed plaintiffs' complaint with prejudice for failure to plead facts with sufficient particularity. *Id.* The Eighth Circuit reversed, holding that § 11 and § 12(a)(2) claims need meet only the notice pleading standard of Rule 8(a). *Id.* at 315-16.

The Eighth Circuit acknowledged a division of authority as to whether § 11 and § 12(a)(2) claims must meet the particularity requirements of Rule 9(b), noting that some circuits have held that such claims must meet the Rule 9(b) requirement if they "sound in fraud" rather than negligence. *See id.* at 315, *citing In re Stac Elec. Sec. Litig.*, 89 F.3d 1399, 1404-05 n.2 (9th Cir. 1996), *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 288 (3d Cir. 1992), *Melder v. Morris*, 27 F.3d 1097, 1100 n.6 (5th Cir. 1994). However, the Eighth Circuit specifically rejected the "sounds in fraud" theory, holding that the heightened "fact pleading" standard is not applicable in §§ 11 and 12(a)(2) claims be-

cause fraud is not an element in such actions. *Id.* at 315. The Eighth Circuit held that "a pleading standard which requires a party to plead particular facts to support a cause of action that does not include fraud or mistake as an element comports neither with Supreme Court precedent nor with the liberal system of 'notice pleading' embodied in the Federal Rules of Civil Procedure." *Id.*[6]

While the Eighth Circuit held in *NationsMart* that § 11 and § 12(a)(2) claims are *never* subject to the Rule 9(b) pleading standard, the Fifth Circuit has staked out an intermediate position, holding that § 11 claims should be evaluated under the Rule 8 "notice pleading" standard if, as here, the claimant disavows that its claim is based on fraud. *See Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, 238 F.3d 363, 369 (5th Cir. 2001). The Fifth Circuit held in *Lone Star* that where a plaintiff's claim under § 11 "expressly do[es] not assert that defendants are liable for fraudulent or intentional conduct and disavow[s] and

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[6] In those circuits that have not yet decided the question, district courts are also divided over the proper pleading standard for §§ 11 and 12(a)(2) claims. Some district courts in other circuits have followed the *NationsMart* approach. *See, e.g., In re Initial Pub. Offering Sec. Litig.*, 241 F.Supp.2d 281, 338-39 (S.D.N.Y. 2003) ("Because there is no need to prove fraud in a § 11 claim, there is no need to satisfy Rule 9(b). Because a plaintiff cannot be required to *plead* something it need not *prove*, I join the majority of courts in this district that have concluded that Rule 9(b) does not apply to § 11 claims.") (emphasis original); *accord In re First Merchs. Acceptance Corp. Sec. Litig.*, No. 97 C 2715, 1998 WL 781118, *11-12 (N.D. Ill. Nov. 4, 1998). Other district courts have followed the "sounds in fraud" approach. *See, e.g., Krieger v. Gast*, No. 4:99-CV-86, 2000 WL 288442, *6 (W.D. Mich. Jan 21, 2000) ("where fraud is alleged, the claim should be tested under Rule 9(b)'s requirements even if the claim may be established without proof of fraud").

disclaim[s] any allegation of fraud . . .[t]hose claims do not 'sound in fraud' and cannot be dismissed for failure to satisfy Rule 9(b)." *Id.*

The Eleventh Circuit's use of a heightened pleading standard—despite Oxford's disclaimer of any reliance on fraud in its § 11 and § 12(a)(2) claims—cannot be reconciled with the decisions of the Fifth and Eighth Circuits. As shown above, the Fifth and Eighth Circuits are themselves in conflict on the precise pleading standard to be applied, but the decisions of both those circuits conflict with the Ninth Circuit's decision in *In re Stac Elec. Sec. Litig.*, the Third Circuit's decision in *Shapiro*, and the Eleventh Circuit's decision in this case. Uniformity in the application of the federal securities laws requires that this Court review the decision below.

3. To the extent that the Eleventh Circuit may have derived its "fact pleading" standard for § 11 claims from the PSLRA, its decision is contrary to the language of that statute, which creates a heightened pleading standard for claims under the 1934 Act, but not for 1933 Act claims, such as those presented here. The PSLRA added § 21D to the 1934 Act. That section requires a claim under § 10(b) of the 1934 Act to specify each misleading statement, the reason why the statement is misleading, and particular facts "giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(1)-(2). Although the PSLRA expressly created a heightened pleading standard for 1934 Act claims, it did not change the pleading standard for 1933 Act claims, such as those brought under §§ 11 and 12(a)(2). *Compare* 15 U.S.C. § 77z-1, *with* 15 U.S.C. § 78u-4. The PSLRA added § 27 to the Securities Act of 1933. That section parallels the provisions of § 21D in many ways, and provides substantially identical procedural changes. However, § 27 of the 1933 Act—unlike § 21D of the 1934 Act—specifically omits

a parallel heightened pleading standard for § 11 and § 12(a)(2) claims. 15 U.S.C. § 77z-1.

The Eleventh Circuit's decision also conflicts with the Eighth Circuit's holding that the PSLRA's heightened pleading standard is inapplicable to § 11 claims. In *Romine v. Acxiom Corp.*, 296 F.3d 701, 704 (8th Cir. 2002), the Eighth Circuit noted that the heightened PSLRA pleading standard does not apply to claims brought under the 1933 Act. The *Romine* court held that the PSLRA left the Rule 8(a) pleading standard for § 11 claims intact: "[t]he structure and legislative history of that Act persuade us that § 78u-4 applies only to fraud actions brought under the Securities Exchange Act of 1934 . . . [a]ccordingly, *NationsMart* remains a controlling precedent, and plaintiffs' complaint need only comply with the short and plain statement requirements of Rule 8(a)." *Romine*, 296 F.3d at 704-05; *see also Falkowski v. Imation Corp.*, 309 F.3d 1123, 1133 (9th Cir. 2002).

4. Finally, as this Court has previously held, the federal courts do not have a roving commission to impose pleading requirements more demanding than those established by Congress: a requirement of greater specificity for particular claims "is a result that must be obtained by the process of amending the Federal Rules, and not by judicial interpretation." *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993); *accord Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 512-13 (2002).

It is clear that the heightened pleading requirement imposed by the court below is improper. Because of the conflict among the circuits on this important question of federal law, review by this Court is necessary.

II. Whether, As A Matter Of Law, Material Facts May Be Withheld From Disclosure In A Prospectus Without Leading To Liability Under §§ 11 and 12(a)(2) Is An Important Question Of Federal Law Upon Which The Courts Of Appeals Are Divided.

The Eleventh Circuit's determination that Kos should be deemed not liable as a matter of law under §§ 11 and 12(a)(2), despite its omission of material prescription data from its prospectus, conflicts with the Second Circuit's decision in *Kronfeld v. Trans World Airlines, Inc.*, 832 F.2d 726 (2d Cir. 1987). In *Kronfeld*, the court recognized that material facts must be disclosed in offering materials, and that a finding of materiality ends the inquiry and necessarily subjects the non-disclosing issuer to strict liability.

The Eleventh Circuit effectively amended the disclosure requirements of § 11, dismissing Oxford's complaint despite finding that Kos's prospectus omitted material data regarding the first eight weeks of Niaspan prescriptions. (App. 11-16.) In so holding, the Eleventh Circuit stated that "[w]e join with the First Circuit in recognizing that the 'mere possession of material nonpublic information does not create a duty to disclose it.'" (App. at 12, *citing Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1202 (1st Cir. 1996).) The Eleventh Circuit stated that "to require *all* material information to appear in the prospectus would, like setting the threshold for materiality too low, result in registrants burying the shareholders in an avalanche of trivial information." (*Id.*) In other words, the Eleventh Circuit held that the omitted prescription data was "material" for purposes of its "materiality" analysis, but not sufficiently important to warrant disclosure. The court made this determination, of course, in the context of a

motion to dismiss.[7]

In *Kronfeld*, the Second Circuit recognized that such a paradoxical conclusion is inconsistent with the simple strict liability standard which the statute establishes for §§ 11 and 12(a)(2) claims. The district court in *Kronfeld* disposed of plaintiff's § 11 claim on summary judgment, holding that the defendant had no duty to disclose the omitted information concerning a prospective corporate restructuring. The Second Circuit reversed. In doing so, the court of appeals noted that the district court's decision "might be taken to mean that the district court followed a two-step analysis under Section 11 of the Act—one focusing first upon duty to disclose and thereafter on materiality. . . . [That approach] finds no support in the language of Section 11 of the 1933 Act, or in the few cases which have interpreted it." *Kronfeld*, 832 F.2d at 730 n.8.[8] The Second Circuit also found the two-step analysis for an issuer's liability inconsistent with this Court's decision in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382

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[7] The Eleventh Circuit interpreted the First Circuit's ruling as requiring a two-step liability analysis: (1) asking whether the omitted data was material, and (2) separately analyzing whether the issuer had a duty under §§ 11 and 12(a)(2) to disclose the omitted data. (App. 9, 11-12.) As for the first step, the Eleventh Circuit disagreed with the district court's conclusion and assumed that the prescription data was material. (App. 11.) However, the Eleventh Circuit found that Kos nevertheless had no duty under §§ 11 or 12(a)(2) to disclose that material information. (App. 11-16.)

[8] The *Kronfeld* court gave the district court the benefit of the doubt, concluding that the district court must have meant to hold that the undisclosed information was immaterial as a matter of law. *Kronfeld*, 832 F.2d at 730 n.8. Such an inference is not possible here, where the Eleventh Circuit expressly assumed that the omitted prescription data was material.

(1983), in which this Court held that a plaintiff "need only show a material misstatement or omission to establish [a] *prima facie* case" for a § 11 violation, and that "liability against the issuer of a security is virtually absolute, even for innocent misstatements." 459 U.S. at 382 (holding that "Section 11 places a relatively minimal burden on a plaintiff.")[9]

In *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259 (2d Cir. 1993), the Second Circuit subsequently confirmed that there is no need, even under the arguably less stringent disclosure standard for § 10(b) claims, to analyze separately whether there was a duty to disclose, when the omission of an existing fact would render a prior statement misleading. The *Time Warner* court noted that: "[i]f a reasonable investor would . . . regard the omitted fact [as material], it is difficult to imagine a circumstance where the prior statement would not be rendered misleading in the absence of the disclosure." *Id* at 268.

The Second Circuit's view is undoubtedly correct. If a fact is material to a securities offering it must be disclosed. To be material, and yet not subject to disclosure, is a logical impossibility under §§ 11 and 12(a)(2). In that sense, the Second Circuit's view is consistent with this Court's recognition that the 1933 Act "was designed to provide investors with *full disclosure of material information* concerning public offerings of securities in commerce." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 195 (1976) (emphasis added). This purpose of full disclosure is also manifest in this Court's adoption of a strict liability standard for §§ 11 and 12(a)(2) claims, and in its holding that a claimant under those sections need only plead a mate-

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[9] Section 12 has a similar "strict liability" standard. *Printer v. Dahl*, 486 U.S. 622, 638 (1988).

rial misstatement or omission of fact to shift the burden of proof to the issuer. *Herman & MacLean*, 459 U.S. at 382.

The Eleventh Circuit's contrary decision cannot be reconciled with the decisions of the Second Circuit, the absolute liability standard established by this Court, or this Court's holding that a claimant need only show a material misstatement or omission to make out a *prima facie* case under §§ 11 and 12(a)(2). Review of the Eleventh Circuit's decision is therefore warranted in this case.

III. The Eleventh Circuit's Decision To Affirm A Half-Million Dollar Sanction Against Oxford And Its Counsel Is Manifestly Erroneous, Departs From The Ordinary Course Of Judicial Proceedings, And Conflicts With A Contrary Decision Of The Seventh Circuit.

The Eleventh Circuit upheld a half-million dollar sanction against Oxford and its counsel for failing to meet the "fact pleading" standard it applied for the first time in this case. As we have shown (*see* pages 11-16, *supra*), the Eleventh Circuit standard is erroneous and cannot therefore support the granting of sanctions. *See Hartmarx Corp. v. Abboud*, 326 F.3d 862, 867 (7th Cir. 2003) *quoting Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405 (1990) ("[a] district court would necessarily abuse its discretion if it based its ruling on an erroneous view of the law"). At all events, the law relating to the proper pleading standard was at best an unsettled question in the Eleventh Circuit prior to the decision below, and it was also the subject of a split among the circuits. The Eleventh Circuit sanctioned Oxford for guessing wrong on how that unresolved question would be decided.

In *Hartmarx*, the Seventh Circuit correctly rejected the view that parties may be sanctioned for guessing wrong

on an unresolved question of law. *Hartmarx*, 326 F.3d at 868. The district court in *Hartmarx* imposed sanctions under the PSLRA and Rule 11 against defendants for fees incurred in litigating certain misstatements concerning the financing of a proposed tender offer. *Id.* at 866. The Seventh Circuit reversed the sanctions award, emphasizing that the scope of a defendant's duty to disclose its financing arrangements was not clear. The *Hartmarx* court held that "[t]he debate between the parties involves a close question of law under this new regime. As such, as long as [defendant] was taking a reasonable legal position on the meaning of the rule, it should not be sanctioned even if the district court concluded that [plaintiff] had the better reading." *Id.*; *accord CJC Holdings, Inc. v. Wright & Lato, Inc.*, 989 F.2d 791, 794 (5th Cir. 1993) ("a trial court should not impose Rule 11 sanctions for advocacy of a plausible legal theory, particularly where, as here, the law is arguably unclear.").

Here, in light of the decisions in *NationsMart* and *Lone Star Ladies*—and the Eleventh Circuit's previous silence on the issue—Oxford's attorneys acted reasonably in thinking that Oxford was required to include only "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a). However, the Eleventh Circuit affirmed the district court's decision to impose a half-million dollar sanction against Oxford and its counsel for wrongly predicting the future course of Eleventh Circuit law. As the Seventh Circuit has recognized, the impact of such a draconian decision extends far beyond the particular party involved: "[i]n exercising its discretion, a district court must also bear in mind that such sanctions are to be imposed sparingly, as they 'can have a significant impact beyond the merits of the individual case' and can affect the reputation and creativity of counsel." *Hartmarx*, 326 F.3d at 867.

The decision approving sanctions in this case is without support, and it so far departs from the ordinary course of judicial proceedings as to warrant review for that reason alone.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

United States Court of Appeals,
Eleventh Circuit.

OXFORD ASSET MANAGEMENT, LTD,

Plaintiff-Appellant,

Lowey Dannenberg & Knapp, P.C. Profit Sharing Plan & Trust, a.k.a. Lowey Dannenberg, Bemporad & Selinger P.C. Profit Sharing Plan,

Plaintiff,

v.

Michael JAHARIS, Daniel M. Bell, et al.,

Defendants-Appellees.

Oxford Asset Management, Ltd,

Plaintiff-Appellant,

Lowey Dannenberg & Knapp, P.C. Profit Sharing Plan & Trust, a.k.a. Lowey Dannenberg, Bemporad & Selinger P.C. Profit Sharing Plan,

Plaintiff,

v.

Michael Jaharis, Daniel M. Bell, Duncan Cocroft, Juan F. Rodriguez, Robert E. Baldini, et al.,

Defendants-Appellees.

Nos. 99-11690, 00-13220.

July 16, 2002.

Before EDMONDSON, Chief Judge, and FAY and GARWOOD, *Circuit Judges.

GARWOOD, Circuit Judge:

In this securities action (our No. 99-11690), plaintiff-appellant Oxford Asset Management, Ltd. (Oxford) appeals the dismissal of its 1933 Act claims.[1] We Affirm.

Oxford also appeals (in our No. 00-13220) the district court's award of $520,091.82 in legal fees to the Kos and Underwriter defendants. We affirm in part, reverse in part, and vacate and remand.

Facts and Proceedings Below

1. Appeal of the dismissal (No. 99-11690)

Kos Pharmaceuticals, Inc. (Kos) is a pharmaceutical company that develops and markets prescription drugs. Kos completed an initial public offering of its common stock on

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* Honorable William L. Garwood, U.S. Court of Appeals for the Fifth Circuit, sitting by designation.

[1] The motions to dismiss were made by defendants-appellees Kos Pharmaceuticals, Inc., Michael Jaharis, Daniel M. Bell, Duncan H. Cocroft, Juan F. Rodriguez, Robert E. Baldini, John Brademas, Steven Jaharis, Louis Lasagna, Mark Novitch, Frederick B. Whittemore (collectively, Kos Defendants) and Cowen & Company, Donaldson Lufkin & Jenrette, Salomon Smith Barney Holdings, Inc., SBC Warburg Dillon Read, Inc. (collectively, Underwriter Defendants).

March 12, 1997, selling 4,772,500 shares at $15 per share. From October 21, 1997, to October 24, 1997, Kos completed a secondary offering of its common stock. On October 21, 1997, Kos filed the prospectus and registration statement for the secondary offering with the Securities and Exchange Commission. The offering price was $42.75. A total of 3,625,000 shares were sold in the secondary offering. Kos sold 1,085,000 shares. Michael Jaharis, Kos's founder, majority shareholder and chairman, sold 2,390,000 shares. Daniel Bell, Kos's president and chief executive officer, sold 150,000 shares.

*1186 Kos's only prescription drug product that was publicly available at the time of the secondary offering was an extended release niacin preparation called Niaspan. Niaspan was approved by the Food and Drug Administration in July 1997. Kos began shipping Niaspan to wholesalers in August 1997, and its sales force began detailing physicians in September 1997. On November 12, 1997, a Salomon Brothers analyst, Robert Uhl, released a report in which he slashed Kos's projected revenue for 1998 by half, from $92 million to $46 million, and changed the rating of Kos's stock from buy to hold. The next day, the price of Kos's stock plummeted from $30-15/16 to $16 9/16 per share. Uhl's report was premised on estimates[2] of the numbers of new and refill prescriptions for Niaspan during the first eight weeks that Kos's sales force marketed Niaspan. Uhl's conclusions were based on the assumption (that he and many other pharmaceutical analysts apparently share) that the number of new prescriptions filled during the eighth week of a new prescription drug product's initial marketing is particularly predictive of the market success the product will enjoy. The eighth week of Niaspan's marketing ended on October 31, 1997. Uhl stated

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[2] These estimates were provided by IMS America.

that to achieve the original $92 million revenue projection, 5,000 new prescriptions of Niaspan during the eighth week were needed. IMS America estimated that only 708 new prescriptions for Niaspan were filled during the eighth week. Uhl explained that, considering the small size of Kos's sales force and their program of providing sample packs (which contain a three-week supply of Niaspan) to physicians, he would have been satisfied with 4,000 new prescriptions during week eight. Uhl concluded by noting that due to the sampling program and the anti-niacin bias of many physicians, Niaspan could be the first drug for which the "initial weekly prescriptions are not indicative of the product's ultimate success."

Kos's fifty-two page prospectus, filed October 21, 1997, explained the many risks of investing in Kos, among them: 1) "The Company's ability to successfully commercialize *Niaspan* will depend significantly on the acceptance of *Niaspan* by physicians and their patients"; 2) Niaspan has been designed to minimize the severity of the side effect of flushing, but most patients taking Niaspan will experience flushing and "there can be no assurance . . . that patients using Niaspan will not suffer episodes of flushing that they consider intolerable."; 3) Kos's clinical trials indicate that less than one per cent of patients taking Niaspan experience clinically significant elevations in liver enzymes, but physicians have historically been reluctant to prescribe niacin preparations because of such risk and it is possible that the actual incidence of hepatotoxicity will exceed one per cent; 4) Kos has fewer marketing resources than its competitors, a smaller sales force, and "limited" marketing experience, which could prevent *Niaspan* from achieving "market acceptance"; 5) "during the initial months following the launch of *Niaspan*, many physicians may start only a limited number of selected patients on *Niaspan*"; 6) physicians' anti-niacin bias combined with the distribution of three-week starter packs (which are dispensed without

prescription) may result in only a modest increase in Niaspan prescriptions for the first three to six months of its marketing; and 7) since its inception, Kos had lost about $80 million and there can be no assurance that Kos will ever achieve profitability.

On August 10, 1998, Oxford and Lowey, Dannenberg & Knapp, P.C. (Lowey) filed this suit in the northern district of Illinois. On December 7, 1998, the action was *1187 transferred to the southern district of Florida. Plaintiffs brought this action as a proposed class action. [3] Oxford proposed to represent plaintiffs that purchased Kos stock in the secondary offering. Lowey proposed to represent plaintiffs that purchased Kos stock on the open market between July 29, 1997, and November 13, 1997. The complaint alleged violations of sections 11(a), 12(a)(2) and 15 of the 1933 Act, 15 U.S.C. § § 77k(a), 77l(a)(2) and 77o, sections 10(b) and 20(a) of the 1934 Act, 15 U.S.C. § § 78j(b) and 78t(a), and Rule 10(b)(5), 17 C.F.R. § 240.10b-5. The complaint also alleges common law fraud, negligent misrepresentation and breach of fiduciary duty. All of the causes of action in plaintiffs' original complaint are based on defendants' alleged material misrepresentations and omissions (in press releases, the prospectus, the registration statement, and other SEC filings) concerning the safety, efficacy, tolerability and sales volume of Niaspan. On January 7, 1999, the Kos defendants moved to dismiss the complaint pursuant to Fed.R.Civ.P. 12(b)(6). The Underwriter defendants so moved on February 8, 1999. At the dismissal hearing, the plaintiffs advanced a new basis for recovery, namely that the prospectus should have disclosed the first six weeks of IMS America's estimates of Niaspan's prescription volume. In the interests of justice,

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[3] The district court's dismissal of the complaint mooted the class certification issue. Thus, that issue was not resolved.

the district court considered this as an amended claim. On May 19, 1999, the district court granted the motions to dismiss, holding that the omission of the prescription volume data was immaterial as a matter of law and that plaintiffs' allegations as to the safety, efficacy, tolerability and sales volume of Niaspan were mere legal conclusions masquerading as facts. On August 3, 1999, the district court dismissed the complaint with prejudice.

Oxford appeals the dismissal of its 1933 Act and the common law claims of fraud and negligent misrepresentation, but admits that dismissal of the common law claims was proper if dismissal of the federal claims was proper. Oxford does not appeal the dismissal of its 1934 Act claims. Lowey, which was not named as a plaintiff in the 1933 Act counts, does not appeal to this Court.

2. Appeal of the attorneys' fees award (No. 00-13220)

On July 6, 1999, the Kos defendants moved for sanctions pursuant to the Private Securities Litigation and Reform Act (PSLRA) and Rule 11. On July 16, 1999, the Underwriter defendants so moved. On January 31, 2000, the district court granted the motions for sanctions, finding that the plaintiffs were deliberately indifferent to the lack of factual support for the allegations in the complaint and that, therefore, the complaint was objectively frivolous. On May 22, 2000, the district court awarded $502,576.82 in attorney's fees to the defendants. On June 7, 2000, the district court clarified its earlier order and increased the award to $520,091.82. Oxford appeals the district court's grant of defendants' motions for sanctions and its award of attorney's fees to defendants.

3. Consolidation

This Court subsequently granted Oxford's motion to consolidate the appeals for oral argument.

Discussion

I. Standard of Review

This court reviews de novo the dismissal of a complaint pursuant to Rule 12(b)(6). ***1188** *Harris v. Ivax Corp.*, 182 F.3d 799, 802 (11th Cir.1999). The plaintiff's factual allegations are accepted as true. *South Florida Water Management Dist. v. Montalvo*, 84 F.3d 402, 406 (11th Cir.1996). Dismissal is not appropriate unless it is plain that the plaintiff can prove no set of facts that would support the claims in the complaint. *Id.* However, conclusory allegations, unwarranted deductions of facts or legal conclusions masquerading as facts will not prevent dismissal. *Id.*; *Fernandez-Montes v. Allied Pilots Ass'n*, 987 F.2d 278, 284 (5th Cir.1993).

II. District Court's Consideration of Documents Attached to the Kos Defendants' Motion to Dismiss

In resolving the defendants' motions for dismissal, the district court considered the prospectus, which was attached to the complaint; Kos's 10-Q for the period ending September 30, 1997, which was required to be and was actually filed by Kos with the SEC; the Uhl report, quoted in the complaint; a July 29, 1997, press release, quoted in the complaint; a November 12, 1997, press release, quoted in the complaint; a 1996 article about Niaspan, quoted in the complaint; and the Niaspan package insert. All of these documents were attached to the Kos defendants' motion to dismiss. Oxford contends that consideration of such "matters outside of the pleadings" was improper on a

motion to dismiss, and that the district court should have converted the motion to dismiss into one for summary judgment. We disagree. In a motion to dismiss a securities action, a court may consider the contents of public disclosure documents which are required to be filed with the SEC and are actually so filed. *Bryant v. Avado Brands*, Inc., 187 F.3d 1271, 1277-78 (11th Cir.1999). The documents may only be considered to show their contents, not to prove the truth of matters asserted therein. Neither do we find error in the district court's use of the Uhl report, the press releases or the 1996 article. *See Harris v. Ivax Corp.*, 182 F.3d 799, 802 n. 2 (11th Cir.1999). The package insert for Niaspan was not referred to in the complaint, but the district court reasoned that its contents could be judicially noticed because "it is a matter of public record (part of the FDA public file), is included in every package of Niaspan, and also listed in the Physician's Desk Reference." The district court specifically stated it was not accepting the facts asserted in the insert as true, and appears only to have used it to show the bare existence of a clinical study which stated that Niaspan could increase HDL cholesterol by 32%. We find no error in this.

III. Section 11 Claims

Section 11(a) of the 1933 Act, 15 U.S.C. § 77k, provides a cause of action to purchasers of securities where: "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading. . .." Section 11 extends liability to every person who signed the registration statement, the issuer's directors, and every underwriter. Section 12(a)(2) of the 1933 Act, 15 U.S.C. § 77l, imposes liability upon one who sells a security "by means of a prospectus or oral communication,

which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading. . .." Section 15 of the 1933 Act, 15 U.S.C. § 77o, extends Section 11 and 12 liability to persons who control entities liable under those sections. Thus, to state a claim under any of these sections, Oxford must properly allege a *1189 material misrepresentation or a material omission.

A. Omission of Prescription Volume Data

To avoid dismissal of a section 11 omission claim, plaintiffs must properly allege: 1) the prospectus contained an omission; 2) the omission was material; 3) defendants were under a duty to disclose the omitted material information; and 4) that such information existed at the time the prospectus became effective. *Cooperman v. Individual, Inc.*, 171 F.3d 43, 47 (1st Cir.1999). The complaint (as amended at oral argument before the district court) alleges that: 1) Kos possessed the first seven weeks of Niaspan's prescription volume history; 2) this information was material; 3) issuers have a duty to disclose all material information in the prospectus; and 4) the absence of the prescription volume information rendered the prospectus misleading.

1. Materiality

The district court assumed that Kos was in possession of "several weeks" of information, but held that, because Uhl based his conclusions almost entirely on the number of new prescriptions for Niaspan filled during the eighth week (which occurred after the close of the offering), the partial, preliminary information Kos possessed was not material. The district court also noted the prospectus's mention of several obstacles to the market acceptance of Niaspan,

including a specific warning that Niaspan's sales may grow slowly during the first three to six months of its marketing.

The test of materiality is well known. "[T]o fulfill the materiality requirement 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.' " *Basic Incorporated v. Levinson*, 485 U.S. 224, 108 S.Ct. 978, 983, 99 L.Ed.2d 194 (1988) (quoting *TSC Industries, Inc. v. Northway*, Inc., 426 U.S. 438, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976)). The trier of fact usually decides the issue of materiality. *Cooperman*, 171 F.3d at 48-49. Only if the lack of importance of the omission is so plain that reasonable minds cannot differ thereabout is it proper for the court to pronounce the omission immaterial as a matter of law. *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 161-64 (2nd Cir.2000); *Cooperman*, 171 F.3d at 49.

We are willing to assume, at the dismissal stage, that Kos possessed whatever prescription volume information existed. We do not know how quickly the IMS America estimates became available, but some delay or lag time seems inevitable. The prospectus was filed October 21, 1997. Oxford purchased its stock on October 24, 1997, the last day of the seventh week of Niaspan's marketing. Thus, Oxford's assertion that Kos possessed seven weeks of data is literally unbelievable. Even though Kos probably did not possess even six weeks of information, for dismissal purposes we will assume that it did.

Realizing that no argument could be made that Kos possessed the critical eighth week of information, Oxford characterizes the partial data as a material trend. During the sixth week, there were 498 new prescriptions for Niaspan. Oxford's point appears to be that, considering the first six weeks of data, it was very unlikely that Niaspan

would achieve the Uhl goal of 4,000 to 5,000 new prescriptions per week, and therefore a reasonable investor would consider the total mix of information significantly altered by the data's inclusion. The district court correctly observed that the prospectus explains the several reasons *1190 why Niaspan may start more slowly than other drugs. However, the immateriality of the six weeks of prescription information is arguably not so plain that reasonable minds could not differ about it. Accordingly, we will assume for purposes of the motion to dismiss that the six weeks of prescription volume information was material.

2. Duty to Disclose

Oxford asserts three bases for Kos's duty to disclose the prescription data in the prospectus: 1) a general duty to disclose, in the prospectus, all information material to the offering; 2) Item 303(a)(3)(ii) of regulation S- K, 17 C.F.R. § 229.303(a)(3)(ii); and 3) the omission of the prescription data rendered the prospectus materially misleading. We address each of these arguments in turn.

(a.) General Duty

Oxford first argues that issuers have a duty to disclose, in the prospectus, all information material to the offering. We disagree. Section 11(a) only makes actionable the omission of a material fact required to be stated in the prospectus or necessary to make the statements in the prospectus not misleading. To hold that section 11(a) imposes liability unless the prospectus includes all material facts is simply to wholly ignore and render superfluous that section's qualifying language "required to be stated therein or necessary to make the statements therein not misleading." This we may not do. Moreover, considering that materiality will usually be an issue for the trier of fact, to

require *all* material information to appear in the prospectus would, like setting the threshold for materiality too low, result in registrants burying the "shareholders in an avalanche of trivial information-a result that is hardly conducive to informed decisionmaking." *Basic Inc. v. Levinson*, 485 U.S. 224, 108 S.Ct. 978, 983, 99 L.Ed.2d 194 (1988) (quoting *TSC Industries, Inc. v. Northway*, Inc., 426 U.S. 438, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976)). We join with the First Circuit in recognizing that the "mere possession of material nonpublic information does not create a duty to disclose it" and that the duty question is properly stated as "whether the defendants had a specific obligation to disclose information of the type that the plaintiffs complain was omitted from the registration statement and prospectus." *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194, 1202 (1st Cir.1996). If the prospectus contains all of the *material* information specifically required by the securities laws, does not contain an untrue statement of a material fact and if the statements therein are not materially misleading in any respect, there has been no material misrepresentation or material omission.

(b.) Item 303(a)(3)(ii)

In its reply brief, Oxford asserts, for the first time, that disclosure of the prescription volume estimates was required by Item 303(a)(3)(ii) of regulation S-K, 17 C.F.R. § 229.303(a)(3)(ii). While we need not consider this untimely argument, even if we did consider it, it, too, would fail.

Other circuits have considered whether or in what circumstances Section 11 liability may be premised upon the failure to disclose information required by Item 303. *See Oran v. Stafford*, 226 F.3d 275, 288 (3d Cir.2000); *Steckman v. Hart Brewing Inc.*, 143 F.3d 1293, 1296 (9th Cir.1998). However, we need not explore those questions because we

conclude that in any event Item 303 did not require that the prospectus disclose the first six weeks' prescriptions.

Item 303(a)(3)(ii) requires registrants to:

> "Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a ***1191** material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed."

Oxford argues that the prescription data constitutes a known trend that Niaspan was "not selling or being prescribed" and that, therefore, Item 303(a)(3)(ii) requires its disclosure. There are, at least, two independently sufficient reasons why this contention cannot be sustained.

The first element of the Item 303 disclosure test set forth in Securities Act Release 6835 requires management to assess whether the "known trend, demand, commitment, event or uncertainty [is] likely to come to fruition." Securities Act Release No. 33-6835, 1989 WL 192885 at *6 (S.E.C.). As regards trends, we interpret this element to require an assessment of whether an observed pattern accurately reflects persistent conditions of the particular registrant's business environment. It may be that a particular pattern is, for example, of such short duration that it will not support any conclusions about the registrant's business environment. Release 6835 states that management's assessment "must be objectively reasonable, viewed as of the time the determination is made." *Id.* We interpret this language as establishing a negligence standard.

Oxford's complaint says nothing about Item 303. Moreover, it does not allege facts that, if true, would support a

finding of negligence as to Kos management's belief that the prescription data did not reflect that the uncertainties identified in the prospectus had been resolved against the marketability of Niaspan. This deficiency is highlighted by Uhl's discussion of Kos management's disagreement with his new projection, in which he specifically notes the experience and competence of Kos's management team and mentions several steps that could be taken to "help bolster awareness of the product." Uhl concludes with a significant admission: "Niaspan could be the first product of which we know where initial weekly prescriptions are not indicative of the product's ultimate success." The complaint alleges that management's assessment was incorrect and repeatedly emphasizes that, as to the issuer, Section 11 imposes strict liability for material omissions. However, in determining the existence of an omission based on Item 303's disclosure requirements, Release 6835 clearly established a negligence standard. Oxford's failure to allege facts from which the objective unreasonableness of Kos management's decision not to include the prescription information in the prospectus could be inferred forecloses reliance upon Item 303 as a source of a duty to disclose that information.

A second, even clearer, barrier to Oxford's reliance upon Item 303(a)(3)(ii) is that it is primarily concerned with developments that render the registrant's reported results less indicative of the registrant's future prospects, a concern not implicated here. Instruction 3 to paragraph (a) provides:

"3. The discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of (A) matters that would have an impact on future operations and have not had an impact in the past, and (B) matters that have had an impact on reported

operations and are not expected to have an impact upon future operations."

***1192** Item 303(a)(3)(ii) essentially says to a registrant: If there has been an important change in your company's business or environment that significantly or materially decreases the predictive value of your reported results, explain this change in the prospectus. The obvious focus is on preventing the latest reported results from misleading potential investors, thereby promoting a more accurate picture of the registrant's future prospects.

Here, the prescription data was used by a market analyst to make a projection. This projection disappointed the market, which had been very optimistic about Kos because of the market analyst's prior, more favorable projection. However, *the market's disappointment in the changed revenue projection did not render Kos's previously reported results unreliable. See Glassman v. Computervision*, 90 F.3d 617, 632 (1st Cir.1996). The prospectus stated that Kos had lost almost $80 million since its inception and that there could be no assurance that the company would ever be profitable. If booming Niaspan sales had carried Kos for the previous several reported quarters but suddenly and significantly declined, a potential investor could be mislead by those reported results unless Kos disclosed the importance of Niaspan and discussed the downward trend in Niaspan sales. That is the type of situation Item 303(a)(3)(ii) was designed to address. But that is *not this* case. Because the prescription information did not render Kos's reported results any materially less indicative of the company's future prospects, Item 303(a)(3)(ii) does not require its disclosure.[4]

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[4] We need not address whether Item 303(a)(3)(ii) required Kos to discuss Niaspan's market acceptance as an uncertainty. Kos

(continued...)

(c.) Misleading Prospectus

Oxford also argues that Kos had a duty to include the prescription data because the prospectus was materially misleading without it. We conclude that the prospectus thoroughly explained the risks involved in marketing Niaspan, and specifically warned that Niaspan might have a slow start. The Uhl report mentioned the possibility that Niaspan's first *eight* weeks may not be indicative of its ultimate market success. In view of all of this, the *six* weeks of prescription data, which represents only a *very* preliminary indication that Niaspan was staring slowly, did not have to be included in the prospectus. Such indication did not render materially misleading the prospectus's treatment of the market acceptance of Niaspan as an uncertainty.

In sum, we hold that Kos had no duty to disclose the referenced prescription data in the prospectus.

B. Misrepresentation of Niaspan's Efficacy

The prospectus stated that Niaspan could increase HDL cholesterol by 22% to 32%. Paragraph 47 of the complaint alleges that Niaspan cannot increase HDL cholesterol by up to 32%. The only facts pleaded in support of this bald assertion were the results of two of the four clinical studies

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[4] (...continued)
clearly did so, and the thrust of Oxford's complaint is that Kos's treatment of Niaspan's future as an uncertainty was misleading. We note, however, that Item 101 of Regulation S-K, 17 C.F.R. § 229.101, appears to require this kind of discussion. Item 101 requires a description of the registrant's business, including a discussion of the registrant's products. Item 101(c)(1)(ii) requires a narrative description of the status of products being developed and new products.

relied upon by Kos in stating the 22% to 32% range. These two studies showed that Niaspan could increase HDL by 23% and 26%. Kos claims that one of the four studies shows Niaspan can increase HDL by 32%. A study noting such ***1193** results is referred to in Niaspan's package insert. At oral argument before this Court, Oxford complained that it had never seen this study and reiterated its view that the 32% claim was false.

The fatal flaw in Oxford's position is the complaint's failure to allege facts that support the conclusion that the 32% claim is false. As mentioned, the complaint only references two studies, both of which are consistent with the 22% to 32% *range* set forth in the prospectus. The district court held that because both numbers from these sources were in the range quoted in the prospectus, neither was evidence that this range was false. We agree. No two clinical trials will produce exactly the same results. Cherry-picking two studies that show average HDL improvement of less than 32%, even significantly less, does not tend to establish that the stated *range* is false.

C. Misrepresentation of Niaspan's Safety

The prospectus stated that only about 1% of patients taking Niaspan experienced clinically significant increases in liver enzymes and that the threshold for clinical significance was three times the normal level. [5] Paragraph 51 of the complaint alleges that "Niaspan use elevated liver toxicity to an intolerable and unsafe level. By defining clinically significant elevations in liver function tests as

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[5] When liver cells are destroyed, certain enzymes that were contained within those cells spill into the bloodstream. Elevation of these enzymes indicates that liver cells are dying at an accelerated rate.

'greater than three times the upper limit of normal,' Kos misrepresented the industry standard as to what constitutes tolerable and safe levels of liver toxicity."

The complaint does not plead the existence of facts that would support its allegation that Niaspan elevates liver enzymes to an intolerable level. The complaint fails to articulate what the proper threshold for clinical significance is, although, after the motions to dismiss were granted, Oxford asserted, in its response to the defendants' motions for sanctions, that it is twice the normal level. No studies are referred to, no specific facts are pleaded that indicate any basis for Oxford's bald assertions that Niaspan elevates liver enzymes to an intolerable level or that Kos employed the wrong standard in its clinical trials.

In its response to defendants' motions to dismiss, Oxford added an additional "safety" claim, which the district court, in the interest of fairness, considered. This claim was that the prospectus is misleading because it did not state that 88% of patients taking Niaspan would experience flushing. As regards the flushing issue, the prospectus stated: "Although most patients taking Niaspan will sometimes flush, the formulation and dosing regimen for Niaspan have been designed to maximize patient acceptance and minimize the occurrence of flushing. There can be no assurance, however, that patients using Niaspan will not suffer episodes of flushing that they consider intolerable." In view of this and other candid statements about the side effect of flushing that appear in the prospectus, we hold that the prospectus was not misleading in this respect.

D. Misrepresentations of Niaspan's Tolerability

Paragraph 63 of the complaint observes that subjects in Kos's clinical trials were given 2,000 mg of Niaspan per day and alleges that "only a tiny fraction of the market could

tolerate such a high dose of Niaspan." The complaint alleges that the clinical studies were "rigged" because Kos "only administered high doses of Niaspan to subjects who were predetermined to *1194 have a high tolerance." The complaint does not even specify what side effect prevents all but a tiny fraction of the market from taking Niaspan. When, at oral argument, the district court asked for an explanation of the charge that the clinical trials the FDA based its approval on were "rigged", Oxford's response was that there must be some reason "why physicians don't prescribe it." We agree with the district court that the complaint fails to plead any factual basis for the charges found in paragraph 63.

E. Misrepresentation of $1.5 Million in September 1997 Sales

The prospectus estimated that Kos reaped $1.5 million in revenue from the sale of Niaspan during the quarter ending September 30, 1997. On November 12, 1997, Kos filed its 10Q for that quarter, which, consistent with the prospectus's estimate, stated that Kos had realized initial product sales of Niaspan in the amount of $1.5 million. Paragraph 57 of the complaint alleges that the claim of $1.5 million in sales of Niaspan was false. The complaint does not allege any facts that support the conclusion that Kos had not sold $1.5 million in Niaspan by September 30, 1997, or that the $1.5 million figure was inaccurate in any respect. Paragraph 58 of the complaint alleges that, even if $1.5 million in sales did occur, such sales did not result from prescriptions, but rather from pipeline filling sales to wholesalers. The complaint alleges that Kos's statement, in the prospectus, that it "intends to market Niaspan directly to the specialist physicians within the cardiovascular market" somehow rendered the prospectus misleading without a statement clarifying that the $1.5 million in sales was to wholesalers.

The prospectus stated that Kos's sales force was providing "as a promotion item" three-week starter packs of Niaspan to physicians, which "generally are dispensed without a prescription", and that sales to warehouses commenced before the sales force began to market Niaspan to physicians. It is common knowledge in the pharmaceutical industry that "direct marketing" to physicians entails promoting the drug product to physicians and encouraging them to prescribe it for their patients. The prospectus simply does not state or imply that the $1.5 million resulted from prescriptions or direct sales of Niaspan to physicians. The prospectus also plainly stated that Kos was selling Niaspan to wholesalers. The complaint has failed to plead facts that, if true, would constitute a misrepresentation of sales revenue, and does nothing more than offer the legal conclusion that the representation in the prospectus was somehow misleading.

We hold that the dismissal of Oxford's federal claims, with prejudice, was entirely proper.

IV. Attorneys' Fee Award

15 U.S.C. § § 77z-1(c) and 78u-4(c) require the district court, upon final adjudication of claims brought under the 1933 and 1934 Acts, respectively, to include specific findings as to each party's and each attorney's compliance with Fed.R.Civ.P. 11(b). These subsections also provide for a presumption that the proper sanction for a Rule 11(b) violation is an award, to the opposing party, of the reasonable attorney's fees and costs incurred as a direct result of the violation.

The district court found that Oxford's legal arguments were not frivolous and that Oxford performed an adequate investigation before filing its complaint, but that after such investigation a reasonable attorney would have realized

that there was no evidentiary support for any of the allegations in the complaint and that such support was unlikely to be unearthed by further investigation or discovery. The district court concluded that the plaintiffs *1195 were deliberately indifferent to the lack of evidentiary support for the conclusory allegations in the complaint and that plaintiffs' claims were objectively frivolous under Fed.R.Civ.P. 11(b)(3). The district court awarded $335,686.55 in fees and expenses to the Kos defendants and $184,405.27 to the Underwriter defendants. The plaintiffs and their counsel were each responsible for half of the award, or $260,045.91.

"An appellate court reviews all aspects of the district court's Rule 11 determination for an abuse of discretion." Worldwide Primates, Inc. v. McGreal, 87 F.3d 1252, 1254 (11th Cir.1996).

The district court concluded that plaintiffs' claim regarding the omission of the prescription data was "not well grounded in fact" because it was essentially an amended claim that was advanced for the first time at the dismissal hearing. In a footnote, the district court observed that: "Just because, 'in the interests of justice,' the Court decided to entertain this 'essentially amended claim' in ruling upon the motions to dismiss, does not mean that the Court has to read Plaintiffs' presentation at oral argument into the Complaint when judging whether Plaintiffs' claims were well grounded in fact." It is true that the complaint's reference to the Uhl report is only in the context of showing that the $1.5 million in Niaspan sales that occurred in September 1997 did not result from prescriptions, and that the plaintiffs did not allege that the prescription data should have been included in the prospectus until the dismissal hearing. The district court appears to have concluded that it is proper to consider such a claim in a motion to dismiss, but then fail to consider the factual allegations advanced in support thereof when resolving a

motion for sanctions. The district court certainly did not have to consider the claim in resolving the motions to dismiss. However, in finding that the thus amended claim was without evidentiary support simply because it was not advanced until the dismissal hearing (and without considering the factual allegations advanced in support of the claim at such hearing), the district court abused its discretion. We conclude that this claim had factual support. The claim fails because we reject Oxford's legal argument as to a registrant's duty to disclose the prescription data under Item 303(a)(3)(ii). This argument, though ultimately rejected, was not frivolous and was adequately supported by the pleaded facts concerning the data and its predictive value.

As to plaintiffs' other claims, we cannot say that the district court's findings as to their lack of evidentiary support represented an abuse of discretion. Therefore, the district court's finding that plaintiffs and their counsel violated Rule 11(b)(3) in advancing these other claims is affirmed.

As to the award itself, plaintiffs complain that: 1) the total number of hours billed by the defendants-1900-was not reasonable considering the claims were dismissed before any discovery took place; 2) some of the defendants' billing records are redacted, vague and do not specify exactly what work the attorney was performing; and 3) the defendants failed to provide hourly rates for a significant portion of the time billed, instead submitting a chart of their average hourly rates.

"[T]he starting point in any determination for an objective estimate of the value of a lawyer's services is to multiply hours reasonably expended by a reasonable hourly rate." *Norman v. Housing Authority of the City of Montgomery*, 836 F.2d 1292, 1299 (11th Cir.1988). Our precedent places the burden of documenting the appropriate hours

and hourly rates on the fee applicant. Id. Oxford does not challenge the reasonableness of the hourly rates submitted by the defendants. As to *1196 the number of hours submitted, "fee counsel should have maintained records to show the time spent on the different claims, and the general subject matter of the time expenditures ought to be set out with sufficient particularity so that the district court can assess the time claimed for each activity. A well prepared fee petition also would include a summary, grouping the time entries by the nature of the activity or the stage of the case." [6] *Id.* at 1303 (citation omitted).

Under this standard, both of the fee applications presented to the district court were likely inadequate. Both contain several time entries that are so redacted that it is impossible to tell (beyond "research") what the attorney was doing. Most of the entries contain some description of the work performed, but there is very little information as to which claim the work pertained to. Thus, the district court could not have determined how many hours were spent defending each claim or accomplishing any particular task. Therefore, it could not have assessed whether any hours should be excluded (as redundant or unnecessary) or the hourly rate reduced (because the number of hours submitted for a particular activity was excessive). *Id.* at 1301, 1305-06.

[14][15] Notwithstanding these difficulties, a district court faced with an inadequate fee application must still award a reasonable fee. *Id.* at 1303. Because courts are considered experts in this area, it is usually proper for the district court to award reasonable fees without an evidentiary hearing or additional pleadings. *Id.* Although the

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[6] We view a summary as desirable, but not necessary. We read "activity" as referring to a particular task, such as drafting a motion to dismiss.

district court enjoys wide discretion in determining a reasonable fee, "[t]he court's order on attorney's fees must allow meaningful review-the district court must articulate the decisions it made, give principled reasons for those decisions, and show its calculation." *Id.* at 1304.

Here, the district court found the total number of hours submitted by the defendants to be reasonable. The only explanation for this was that the "factual and legal complexities of this case" rendered "unpersuasive" plaintiffs' argument that the number of hours submitted was excessive. It is true that "[s]worn testimony that, in fact, it took the time claimed is evidence of considerable weight on the issue of the time required in the usual case and therefore [to justify a reduction of the hourly rate], it must appear that the time claimed is obviously and convincingly excessive under the circumstances." *Perkins v. Mobile Housing Board*, 847 F.2d 735, 738 (11th Cir.1988). However, in *American Civil Liberties Union of Georgia v. Barnes*, 168 F.3d 423, 430 (11th Cir.1999), we clarified *Perkins*: "[G]iving weight to sworn statements of fee applicants does not mean accepting those statements as gospel. Courts should not delegate their duty to examine and judge the reasonableness of fee applications to the applicants." Among other things, this means that in order to satisfy *Norman's* "meaningful review" requirement, the district court must respond to *specific objections* to a fee application with more than conclusory statements of reasonableness. Id. at 428.

We conclude that the district court did not abuse its discretion in refusing to reduce the hourly rate. It is true that the only explanation proffered by the district court-the factual and legal complexity of the case-is less than compelling. However, Oxford's objection to the total number of hours submitted was not specific. *Barnes* rested, in part, on the principle that "[t]he more specific the objections to a ***1197** fee application are, the more specific the findings

and reasons for rejecting those objections can be." *Id.* at 428-29. Oxford did not propose what number of hours would have been reasonable, and therefore could not recommend any particular adjustment to the hourly rate. Oxford simply asserted, in the most general manner, that defense counsel took too many hours getting the case dismissed. Such a boilerplate objection merits no more of a boilerplate response than that given.

Second, Oxford complains that the redacted time entries made it impossible for it to determine whether any of the work performed by defense counsel was redundant or unnecessary. While some entries were severely redacted, most were not. The district court concluded that surrounding time entries "demonstrate that the time claimed in these entries was spent on this matter, either performing legal research or discussing the case with unidentified individuals." This finding was not an abuse of discretion. The district court did not address the issue of redundance, but we think that where, as here, there is no indication that fee counsel has failed to exercise billing judgment, the total amount of time spent on "research" is reasonable, and the number of entries that fail to contain details about what research is being performed is relatively small, it is within the district court's discretion to include those hours in the award. We caution, however, that where a significant number of entries are severely redacted or it appears that fee counsel has failed to use billing judgment, it may be an abuse of discretion to award fees based on the redacted entries.

Finally, Oxford complains that Kos's counsel has only submitted a chart of average hourly rates for a significant part of the time billed. Oxford advanced this argument before the district court. In response, Kos pointed out that the actual hourly billing rates (along with an unredacted version of most of the time entries) was contained in Exhibit F of the record. That is indeed the case.

Oxford's other contentions regarding the award are so devoid of merit that it was not an abuse of discretion for the district court to fail to address them.

The only issue requiring remand is the proper apportionment of the award. The district court recognized that opposing parties are only entitled to attorney's fees and costs associated with defending frivolous claims. Simon *DeBartolo Group, L.P. v. Richard E. Jacobs Group*, Inc., 186 F.3d 157, 166-67, 177 (2nd Cir.1999). Accordingly, Defense counsel are entitled to fees and expenses incurred in defending against all claims except the claim that Kos should have included the partial, preliminary prescription sales data in the prospectus. We realize that because this claim was not advanced until oral argument at the hearing to dismiss, the amount of fees and expenses incurred in defending against it is probably small. Nevertheless, the law requires that the award not include such fees and expenses. The district court has wide latitude in determining how to apportion the award, but it must explain its decision such that it is capable of meaningful review.

Conclusion

For the reasons stated, the district court's dismissal of Oxford's federal claims, with prejudice, is affirmed. It follows that the district court's dismissal of Oxford's state and common law claims must also be affirmed.

The district court's finding that the plaintiffs and their counsel violated Rule 11(b)(3) by being deliberately indifferent to the lack of factual support for the claims asserted in the complaint is affirmed, except as to the amended claim concerning ***1198** the omission of the preliminary prescription sales data, which is reversed. The district court's award of fees and expenses is vacated and remanded so that the district court can properly apportion the award, i.e.

exclude fees and expenses incurred in defending against the lone non-frivolous claim.

In No. 99-11690, the judgment is AFFIRMED; In No. 00-13220, the judgment is VACATED and the matter is REMANDED for further proceedings consistent herewith.

APPENDIX B: DISTRICT COURT DECISIONS

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

OXFORD ASSET MANAGEMENT, et al.	)	
	)	No. 98-2972
v.	)	
	)	[Filed May 19, 1999]
KOS PHARMACEUTICALS, et al.,	)	

ORDER GRANTING MOTION TO DISMISS

THIS CAUSE comes before the Court on Motion by Kos Defendants[1] to Dismiss the Class Action Complaint ("Kos Motion) (DE#5) and Memorandum of Law in Support of Motion to Dismiss (DE#6), and Underwriter Defendants[2] Motion to Dismiss the Complaint (DE#18). The Court has reviewed the responsive papers and the other pertinent portions of the file and heard argument of counsel on these Motions on May 4, 1999. For the reasons stated below, the Defendants' Motions to Dismiss are granted.

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[1] This Motion is filed on behalf of Defendants Kos Pharmaceuticals, Inc., Michael Jaharis, Daniel M. Bell, Duncan H. Cocroft, Juan F. Rodriguez, Robert E. Baldini, John Brademas, Steven Jaharis, Louis Lasagna, Mark Novitch, and Frederick B. Whittemore (collectively, the "Kos Defendants.")

[2] This Motion is filed on behalf of Defendants Cowen & Company; Donaldson Lufkin & Jenrette; Salomon Smith Barney Holdings, Inc.; and SBC Warburg, Dillon Read, Inc. (collectively, the "Underwriter Defendants").

I. Background

Plaintiffs bring a securities class action on behalf of those individuals who purchased Kos stock between July 29, 1997 and November 13, 1997, including those individuals who purchased common stock in a secondary public offering on October 24, 1997 ("the Offering"), as well as those who purchased common stock on the open market during the class period. ¶ 27. Lead Plaintiffs in this action are Oxford Asset Management, which bought shares pursuant to the Secondary Public Offering,[3] ¶ 10; and Lowey Dannenberg, which bought shares in the open market. ¶ 11. Named as Defendants are (1) Kos Pharmaceuticals, Inc.; (2) certain Kos Officers and Directors[4]; and (3) Underwriters of the Offering[5].

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[3] Although the Kos Defendants assert that Oxford did not buy stock from an Underwriter in the Offering, in resolving this Motion, the Court accepts Oxford's claim that it purchased a number of shares in the Offering, and thus has standing to sue under § 11. Ex. C, Pl. Mem. in Oppos. to Mot. to Dismiss (DE#24). The Underwriter Defendants do not dispute this point. Reply (DE#32).

[4] Specifically, named as Defendants in various Counts are: Michael Jaharis, chairman of Kos' Board of Directors; Daniel Bell, Kos' president and chief executive officer; Duncan Cocroft, senior vice president and chief administrative officer; Juan Rodriguez, controller; Robert Baldini, vice chairman of the Board of Directors; John Brademas, director of Kos; Steve Jaharis, director of Kos; Louis Lasagna, director of Kos; Mark Novitch, director of Kos; and Frederick Whittemore, director of Kos.

[5] Plaintiffs purport to bring this action against the four named Underwriter Defendants (Cowen & Company; Donaldson, Lufkin & Jenrette; Salomon Smith Barney Holdings, Inc.; SBC Warburg Dillon Read, Inc.) individually and as representatives of

(continued...)

The following background information provides the context for evaluation of the claims presented.[6] Defendant Kos Pharmaceutical Inc. ("Kos") is a specialty pharmaceutical company that develops and markets proprietary prescription pharmaceutical products, primarily for the treatment of cardiovascular and respiratory diseases. ¶ 38. Kos developed and markets Niaspan, a pharmaceutical containing niacin, to be used for the treatment of "mixed lipid disorders." Niaspan was approved by the Food and Drug Administration ("FDA") on July 28, 1997. Ex. A, Compl. ("Kos Pharmaceuticals, Inc. October 21, 1997 Prospectus") (hereinafter "Prospectus"). At the time of the October 24, 1997 Offering, Niaspan was Kos' lead product and the sole product that was being marketed.[7] ¶ 39.

Prior to March 12, 1997, Kos was a private entity funded by Kos Investments Inc., an entity controlled by Michael Jaharis. On March 12, 1997, Kos completed an initial public offering at $15 per share of common stock. ¶ 40. Kos

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[5] (...continued)
a class of underwriter Defendants. Plaintiffs request that the Court "enter an Order appointing Cowen, DLJ, Salomon and SBC Warburg as Underwriter Defendant Class representatives." ¶ 116. Because we dismiss the claims brought against the Underwriters, this request is rendered moot.

[6] For the purposes of this Motion to Dismiss, the Court takes the facts as alleged by Plaintiff in the Complaint. As discussed infra, the Court will also consider the Prospectus and certain documents specifically relied upon in the Complaint or closely related to the allegations of the Complaint and capable of judicial notice. Additional consideration of the allegations of the Complaint will follow in the analysis of the sufficiency of the specific claims.

[7] All other products had not completed the development stage at the time of the Offering.

undertook a secondary public offering on October 24, 1997. This Offering was a "firm offering" (underwritten by the Underwriter Defendants) based on the Prospectus and Registration Statement filed with the Securities and Exchange Commission on October 20, 1997. ¶¶ 2, 41. In the time period between the initial public offering in March and the secondary public offering in October the price of common stock climbed substantially: specifically, on July 29, 1997, common stock was trading at $35 per share; on October 20, 1997, at $43; at the time of the Offering, October 24, 1997, at $42.75. ¶¶ 5, 41. The Offering was fully subscribed, and a portion of a reserved over-allotment was sold also, with a total of 3,625,000 shares sold in the Offering at $42.75 per share. Of that total, Kos sold 1,085,000 shares, totaling $46,383,750; Michael Jaharis sold 2,390,000 shares totaling $102,172,500; and Dennis Bell sold 150,000 shares, totaling $6,412,500. ¶¶ 3-4.

The 52-page Prospectus is a thorough document detailing Kos' history, current operations, and future plan for expansion and development. The Prospectus includes significant and repeated cautionary language concerning the risks or uncertainties associated with Kos, namely that: Niaspan was Kos' sole product on the market; Niaspan had entered the market only several weeks before the Offering; Niaspan's success depended on as-yet-unknown physician and patient acceptance; the market was extremely competitive and subject to rapid technological change; Kos had a smaller sales force and fewer resources than established potential competitors; Kos did not have any prior successes in marketing or development; and Kos had never made a profit and had accrued a $80 million deficit to date. Prospectus, pp. 6-13 ("Risk Factors"), pp. 18-20 ("Management's Discussions and Analysis of Financial Condition and

Results of Operations").[8]

On November 12, 1997, Robert Uhl of Salomon Smith Barney published a report ("Uhl Report") that discussed the prospects of Kos and Niaspan and downgraded the stock from a rating of "buy" to "hold." ¶ 43. Ex. 4, Kos Mem. (DE#6). The Uhl Report charted weekly prescription data[9] for the first eight weeks that Niaspan had been available and predicted future sales expectations based on the prescription sales *in the eighth week* of availability, the week ending October 31, 1997. Based on the 708 new prescriptions in that week, the Report concluded that previous sales estimates would have to be reduced by half, and that annual revenue would approximate $1.186 million. Given these revised estimates, the stock was downgraded to a "hold" rating. *Id.* On November 13, 1997, the stock dropped to approximately $16 per share.[10] ¶ 5.

On August 10, 1998, Plaintiffs filed suit in United States District Court for the Northern District of Illinois. Upon Defendant's Motion, this case was subsequently transferred to the Southern District of Florida on December 7, 1998. The Complaint[11] alleges claims under the Sections 11,

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[8] Attached to the Prospectus are "Consolidated Financial Statements" for the time period from Kos' "inception" in July 1988 up to the fiscal year ending June 30, 1997, audited and certified by Arthur Andersen LLP.

[9] The source of this data is IMS, America (an independent company) and Salomon Brothers Inc. estimates. Ex. 4, Kos Motion.

[10] As stated by Plaintiff's counsel at argument, the stock has not recovered and presently trades at an estimated $4 to $6 per share.

[11] Count I– Section 11 of the 1933 Act against all Defendants for issuing a Prospectus with untrue statements of material fact or material omissions; Count II—Section 12(a)(2) of 1933 Act against

(continued...)

12(a)(2), and 15 of the Securities Act of 1993 (related to the Second Public Offering brought by Offering purchaser Oxford); Section 10(b) and 20(a) of the Securities Act of 1934 and Rule 10b-5 promulgated thereunder (alleging securities fraud related to the Offering and to open market purchases); and common law.

Plaintiffs[12] allege that in press releases and SEC filings including the Prospectus and Registration Statement, the Defendants made material misrepresentations and omissions regarding (in Plaintiffs' terms) Niaspan's (1) efficacy, (2) safety, (3) sales volume, and (4) commercial viability, that are actionable under federal securities law and

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[11] (...continued)
Kos, Jaharis, Bell and Underwriters for participating in issuance of Prospectus and Registration Statement with untrue statements or material omissions; Count III—Section 15 of 1933 Act against Jaharis, Bell, Baldini, Brademas, S. Jaharis, Lasagna, Novitch, and Whittemore as control persons in regard to Counts I and II; Count IV—Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder for intentional or reckless material representations or omissions in connection with the sale of securities; Count V – Section 20(a) of 1934 Act against Jaharis, Bell, Baldini, Brademas, S. Jaharis, Lasagna, Novitch, and Whittemore as control persons in regard to Count IV; Count VI—Common Law Fraud against all Defendants; Count VII—Negligent Misrepresentation against all Defendants; Count VIII—Breach of Fiduciary Duty as Directors against Jaharis, Bell, Baldini, Brademas, S. Jaharis, Lasagna, Novitch, and Whittemore.

[12] The Oxford Plaintiffs bring claims related to the Offering Prospectus and Registration Statement; the Lowey Plaintiffs allege additionally that throughout the class period (a period encompassing three months before and three weeks after the Offering), Defendants made fraudulent statements about the medical concerns and sales volume and omitted disclosure of the prescription sales figures.

common law. Although the Complaint is vague, and at times unfocused and repetitive, we find that at the heart of the complaint in this matter are two sets of claims. The first set of claims that will be characterized as the "medical claims" assert material misrepresentations were made about Niaspan's effectiveness at "moving lipids in the right directions"; about the danger of liver toxicity associated with Niaspan use; and about the plausibility of patients taking certain dosages of Niaspan (that would be necessary to get the desired results). The second set of claims that will be characterized as the "sales claims" relate to revenue and sales volume figures for September 1997 and the portion of October 1997 prior to the Offering.[13] Plaintiffs allege that Kos management reported fabricated revenue figures of $1.5 million in the Prospectus, the Form 10-K, and the November 12, 1997 Press Release, in that these figures were the product of "channel-stuffing" to wholesalers. In addition, in argument on the Motion, Plaintiffs assert that a material omission from the Prospectus and/or other publications resulted from not reporting actual prescription sales figures from the six weeks preceding the October 24 Offering.

Defendants have moved to dismiss all of the claims presented on various grounds, including failure to state a claim upon which relief can be granted under the respective federal statutes and common law.

II. Standard of Review for Motion to Dismiss

A. Legal Standard

Defendants move for dismissal of the federal securities law counts for failure to state a claim upon which relief can

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[13] Niaspan was on the market for only six weeks prior to the Offering, September 7–October 18. ¶ 53.

be granted. For the purpose of the motion to dismiss, the complaint is construed in the light most favorable to the plaintiff, and all facts alleged by the plaintiff are accepted as true. *Hishon v. King & Spaulding*, 467 U.S. 69, 73 (1984). It is well-settled that a "complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). The district court reviews the complaint *not* to make a determination of who will ultimately prevail, but rather to determine whether the claimant is entitled to offer evidence to support the claims. *See Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974).

Under Fed. R. Civ. P. 8(a)(2), Plaintiffs are required only to set forth in the complaint "a short and plain statement of the claim showing that the pleader is entitled to relief."[14] The purpose of such pleading is to "give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Conley*, 355 U.S. at 47. The Court, however, cannot rely on those allegations that contain no more than opinions or legal conclusions. *South Florida Water Management Dist. v. Montalvo*, 84 F.3d 402, 409 n.10 (11th Cir. 1996); *accord In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1403 (9th Cir. 1996) (citation omitted), *cert. denied sub nom*, 520 U.S. 1103 (1997) ("Conclusory allegations of law and unwarranted inferences are insufficient to defeat a motion to dismiss for failure to state a claim.").

Although courts must liberally construe and accept as true allegations of fact in the complaint and inferences reasonably deductible therefrom, they need not accept factual claims that are internally inconsistent or facts

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[14] The heightened pleading standards for securities fraud actions governed by the Private Securities Litigation Reform Act are discussed *infra*.

which run counter to facts of which the court can take judicial notice. *See Ellen S. v. Florida Bd. of Bar Examiners*, 859 F. Supp. 1489, 1492 (S.D. Fla. 1994). It is also evident that a court is not bound to accept conclusory allegations, unwarranted deductions, or mere legal conclusions asserted by a party. *See id.; Olpin v. Ideal Nat. Ins. Co.*, 419 F.2d 1250, 1255 (10th Cir. 1969), cert. denied, 397 U.S. 1074 (1970). Moreover, the Court must not "assume that plaintiffs can prove facts not alleged or that defendants violated the [ ] laws in ways not alleged." *Quality Foods de Centro America, S.A. v. Latin American Agribusiness Development Corp., S.A.*, 711 F.2d 989, 995 (11th Cir. 1983). As stated by the Eleventh Circuit, a plaintiff "must plead sufficient facts so that each element of the alleged [] violation can be identified. Conclusory allegations 'will not survive a motion to dismiss if not supported by facts constituting a legitimate claim for relief...'" *Municipal Utilities Bd. of Albertville v. Alabama Power Co.*, 934 F.2d 1493, 1501 (11th Cir. 1991), cert. denied, 513 U.S. 1148 (1995). It is clear, however, that Plaintiff is not required to lay out every fact with "exactitude, nor must recovery appear imminent." *Id.*

Applying this standard to the review of securities class actions under Section 11 on a Rule 12(b)(6) motion, the First Circuit has explained:

> [T]he demands on the pleader are minimal. Nevertheless, minimal requirements are not tantamount to nonexistent requirements. To survive a motion to dismiss, plaintiffs must set forth factual allegations, either direct or inferential, respecting each material element necessary to sustain recovery under some actionable legal theory. This court has previously plotted the dividing line between adequate "facts" and inadequate "conclusions": it is only when . . . conclusions are logically compelled, or at least supported, by the stated facts, that is, when the suggested inference

> rises to what experience indicates is an acceptable level of probability that "conclusions" become "facts" for pleading purposes."

Cooperman v. Individual, Inc. 171 F.3d 43, 47-48 (1st Cir. 1999) Torruella, C.J.)(internal citations and quotations omitted).

Consistent with the foregoing, we shall review in turn Plaintiffs' allegations to determine if they support the conclusions pled.

B. Defendants' Request for Judicial Notice of Exhibits

On consideration of a Motion to Dismiss pursuant to Rule 12(b)(6), the Court's task is to assess the facial sufficiency of the plaintiff's claims for relief. The Court's inquiry, therefore, is generally limited to the Complaint and the attachments thereto. In certain circumstances, however, "where the plaintiff refers to certain documents in the complaint and those documents are central to the plaintiff's claim, then the Court may consider the documents part of the pleadings for purposes of Rule 12(b)(6) dismissal, and the defendant's attaching such documents to the motion to dismiss will not require conversion of the motion in to a motion for summary judgment." *Brooks v. Blue Cross and Blue Shield of Florida, Inc.*, Case No. 95-405-CIV-SM (S.D. Fla. 1995)(Marcus, J.), *aff'd on other grounds*, 116 F.3d 1364 (11th Cir. 1997); *see also Watson v. Bally Mfg. Corp.*, 844 F. Supp. 1533, 1535 n. 1(S.D. Fla. 1993), aff'd, 84 F 3d 438 (11th Cir. 1996), *citing to*, 5A Charles A. Wright and Arthur R. Miller, *Federal Practice and Procedure* § 1357, at 299 (1990) ("In determining whether to grant a Rule 12(b)(6) motion, the Court primarily considers the allegations in the complaint, although matters of public record, orders, items appearing in the

record of the case, and exhibits attached to the complaint, also may be taken into account.").

As applied in a securities fraud context, when deciding a motion to dismiss, the court also "may consider the contents of relevant public disclosure documents which (1) are required to be *field* with the SEC, and (2) are actually filed with the SEC." *Lovelace v. Software Spectrum Inc., 78 F.3d 1015*, 1018 (5th Cir. 1996); *accord Kramer v. Time Warner Inc.*, 937 F.2d 767 (2nd Cir. 1991). Thus, the Court shall consider the facts alleged in the complaint, those documents attached to or incorporated into the complaint, including certain documents that may be judicially noticed such as SEC filings. *See Malin v. IVAX Corp.*, 17 F. Supp. 2d 1345, 1352 (S.D. Fla. 1998) (stating that SEC filings required to be filed and actually filed are appropriate for judicial notice, therefore may be considered in evaluating a motion to dismiss, and that); *Bryant v. Apple South*, 25 F. Supp. 2d 1372, 1376 (N.D. Ga. 1998) (considering newspaper article quoted in complaint because "fairness requires that the entire document be considered" while excluding documents not quoted or mentioned in the complaint).

The Kos Defendants attach ten exhibits to their Motion to Dismiss and request that they be judicially noticed. For the purposes of this Motion to Dismiss, the Court will consider the Complaint, the Prospectus (Ex. A, Compl.), and several documents repeatedly referenced and relied upon extensively in the Complaint: Form 10-Q for the period ended September 30, 1998, that was required to be filed with the SEC and was actually filed (Ex. 10, Kos Motion); the Uhl Report, quoted in the Complaint (Ex. 4, Kos Motion); July 29, 1997 Press Release, quoted in the Complaint (Ex. 5, Kos Motion); November 12, 1997 Press Release, quoted in the Complaint (Ex. 9, Kos Motion); and the 1996 Article "Treatment Effect of Niaspan, a Controlled Release Niacin, in patients with Hypocholesterolemia: a

Placebo Controlled Trial," quoted in the Complaint (Ex. 2, Kos Motion). Lastly, we consider Exhibit 6, the Niaspan package insert because it is a matter of public record (part of the FDA public file), is included in every package of Niaspan, and also listed in the Physician's Desk Reference. Plaintiffs do not question the authenticity of exhibit as attached to the Kos Motion. The Court does not accept the facts therein as true, but rather considers it as a public record, i.e., a document meeting certain criteria and containing certain specific information about Niaspan. We do not consider any of the additional documents filed by the parties.[15]

III. Analysis of Claims Alleging Violations of Section 11, Section 12(a)(2), and Section 15 of the Securities Act of 1933-Counts I, II, and III

The Oxford Plaintiffs[16] allege various Defendants violated three provisions of the Securities Act of 1933 in the October 24, 1997 Offering: Count I (Section 11), Count II (Section 12(a)(2)), and Count III (Section 15). These Sections provide the mechanisms for enforcing the disclosure requirements imposed by the 1933 Act. Under Section 11, a purchaser of a security can bring a cause of action based on any part of the registration statement, where:

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[15] Exhibit 1, the Prospectus, is duplicative. Exhibit 3 and Exhibit 8 are charts depicting stock prices; the Court relies on the stock prices stated in the Complaint. Defendants have withdrawn Exhibit 11. (Kos Reply at 2, n.2.) Affidavits submitted by Plaintiffs are not properly considered in ruling on a Motion to Dismiss.

[16] Counts I, II, and II are brought solely by Oxford, as the plaintiff who purchased in the Offering; Counts IV, V, VI, VII, and VIII are brought by Oxford (for Offering purchases) and Lowey Dannenberg (open market purchases only); Count VIII is brought solely by Lowey Dannenberg (open market purchases only).

> when such part became effective, [it] contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading. . . .

15 U.S.C. § 77k.

Section 11 action imposes liability on every person who signed the registration statement, every person who was a director in the issuer at the time of filing of the registration statement, and every underwriter of the offering.[17] *Id.* Section 12(a)(2) provides that any person who "offers or sells a security . . . by means of a prospectus or oral communication" that contains a materially false statement or that "omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading" shall be liable to any "person purchasing such security from him." 15 U.S.C. § 77(1)(a)(2). Thus, both statutes require a material misstatement or omission made by Defendants and will be analyzed under the Section 11 discussion below.[18]

A. Section 11

To prevail on a Section 11 claim, plaintiff must show (1) that the registration statement contained a misstatement or omission, (2) that was material, and (3) was required to be stated or was necessary to make other statements not

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[17] Also subject to suit, but not applicable on the facts presented, is "every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified" the part in question. 15 U.S.C. § 77k(4).

[18] Section 15 provides for "control person" liability of those individual who control those liable under Section 11 or Section 12. See U.S.C. § 77o.

misleading. *See Shaw v. Digital Equipment Corp.*, 82 F.3d 1194, 1201 (1st Cir. 1996); *In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1403-04 (9th Cir. 1996), cert. denied sub nom., 520 U.S. 1103 (1997); *Krim v. Banctexas Group, Inc.*, 989 F.2d 1435 (5th Cir. 1993). Plaintiffs are not required to plead scienter to state a claim. *See In re Stac*, 89 F.3d at 1404. Rather, liability under Section 11 may be predicated on negligent, or even "innocent," misstatements. *Herman & Maclean v. Huddleston*, 459 U.S. 375, 382 (1983).[19] In the context of alleged misrepresentations, plaintiffs must allege that a statement included is materially false or misleading.

When alleging material omissions, then, plaintiffs must assert a failure to include a fact that is necessary to make other statements not misleading. While federal securities

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[19] In addition, some courts have applied the particularized requirements for pleading fraud under Federal Rule of Civil Procedure 9(b) where the Section 11 or Section 12 claims "sound in fraud." *See, e.g., In re Stac*, 89 F.3d at 1405; *Melder v. Morris*, 27 F.3d 1097 (5th Cir. 1994); *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272 (3rd Cir. 1992). *But see In re Nationsmart Corp. Sec. Litig.*, 130 F.3d 309, 315 (8th Cir. 1997) (noting that "Section 11 does not require proof of fraud for recovery;" not applying Rule 9(b) where complaint expressly disavows any claim of fraud in connection with the Section 11 and Section 12 claims); *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir. 1996) (rejecting argument that Rule 9(b) must be applied where plaintiffs allege defendants actually possessed the information that they failed to disclose). In the instant case, Plaintiff specifically disclaims any reference to fraud in the Counts of the Complaint based on Sections 11, 12 and 15 of the 1933 Act. ¶¶ 66, 77, 85 ("This Count is not based on, and does not contain any averments of fraud . . . . If, through inadvertence or otherwise, any allegations or averments of or constituting fraud are deemed contained or incorporated in this Count, they are hereby withdrawn from this Count.) We do not find it would be appropriate to apply Rule 9(b) to the case before us.

law is clear that silence, absent a duty to disclose, cannot be "actionably misleading," it is equally clear that "the obligations that attend the preparation of [offering] filings embody nothing if not an affirmative duty to disclose a broad range of material information." *See Shaw*, 82 F.3d at 1202.

1. Alleged Misrepresentations Relating to Medical Claims

In regard to the medical claims, Plaintiffs assert the following misrepresentations of "hard" or historical fact, not forward-looking statements.[20]

a. Effectiveness

In regard to the effectiveness of Niaspan, Plaintiffs allege that Kos misrepresented the extent to which Niaspan could "move" lipid measures in the "right direction." Plaintiff contrasts the information reported in the Prospectus with a July 1997 press release and a 1996 article discussing a trial of Niaspan that was sponsored by Kos. ¶ 46. The Prospectus states that Niaspan can decrease low density lipoprotein ("LDL") cholesterol by 14% to 18%; the 1996 article states 14%. The Prospectus states that Niaspan can increase high density lipoprotein ("HDL") cholesterol, referred to as "good cholesterol," by 22% to 32%; the 1996 article states 23% and the July 1997 press release states "up to 26." The Prospectus states that Niaspan can decrease triglycerides from 24% to 35%; the 1996 article

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[20] No specific omissions are alleged; Plaintiffs invoke the term "omissions" to indicate that "true" statements should have been included, as opposed to these false or misleading statements to alert potential purchasers that the claims made about Niaspan or the results quoted were inaccurate or untenable.

states 29%. ¶¶ 46, 47. The Prospectus states that Niaspan can decrease lipoprotein (a) ("lp(a)") from 24% to 36%; the 1996 article states 27%; the July 1997 press release states "up to 24%." ¶¶ 46-48.

These figures are included in the Prospectus in the discussion of "Niaspan Product Development." Prospectus, pp. 24-25. That section explains that these figures are the results of "the Company's three double-blinded, placebo-controlled pivotal trials and the one open label long-term safety study of Niaspan." At 25. As stated in oral argument, Plaintiffs' cited figures are from one of these very studies (one of the three shorter-term studies used by Kos). Defendants do not dispute the results of that study; in fact it was utilized in the reported results, and indeed the percentages quoted by Plaintiffs fall within the ranges reported on page 25. Plaintiffs allege that they have not seen these other studies (referred to in the Prospectus), so they cannot be assured that they are not misleading. Furthermore, at oral argument Plaintiffs' counsel admitted that it was "very possible" that Defendants are "right" about these figures, but this could not be confirmed because he had not reviewed the studies. This claim raises the specter of the "fishing expeditions" that federal securities law reform is struggling to curtail. If this argument were to suffice, any statement in a Prospectus, however well supported, could form the basis of a claim allowing Plaintiffs full discovery to see if they could find any bases for support of the allegation of misstatement or falsity. Plaintiffs' repeated invocation of the "burden" of the stay on discovery under the PSLRA obfuscates the issue presented; in any cause of action, where Plaintiff has merely a suspicion (or less) that it may have a basis for a claim, it is Plaintiff's obligation to investigate prior to bringing a claim, so that it can meet the requirements of Rule 8 and survive a Rule 12(b)(6) motion.

b. *Safety*

The Prospectus states that Niaspan is "patient-friendly" and that "[o]f all patients treated with Niaspan in the pivotal and long-term safety trials, only four patients with normal liver function tests at baseline showed clinically significant elevations in liver function tests (defined as elevations greater than three times the upper limit of normal) during treatment with Niaspan." ¶¶ 49, 50. This claim relates to the following section of the Prospectus that includes a discussion of the adverse side effects associated with niacin, primarily "flushing" and liver toxicity. It further states that Niaspan's unique "controlled-release nature" and nighttime-only dosing regimen "reduces the intolerable side effects and frequent safety problems characteristic of currently available niacin formulations." At 24. It states:

No clinically significant serious adverse safety trends arose during the clinical trials of Niaspan. Of all patients treated with Niaspan in the pivotal and long-term safety trials, only four patients with normal liver function tests at baseline showed clinically significant elevations in liver function tests (defined as elevations greater than three times the upper limit of normal) during treatment with Niaspan and only two patients treated with Niaspan discontinued the drug because of elevations in liver function tests. Niaspan is generally well tolerated. Flushing occurred, on average, less than two times per patient per month, and such episodes subsided over time. The Company believes that such flushing episodes will be acceptable to most patients when they do occur due to the combination of Niaspan's formulation, Niaspan's Once-A-Night™ dosing regimen, and proper dose titration.

At 25.

Again, Plaintiff, without citation to facts or explanation, baldly asserts that Kos misrepresented the industry standard and that Niaspan elevated liver toxicity to an

intolerable and unsafe level. ¶ 51. In addition to failing to provide any support or authority for these assertions, Plaintiff does not even state what the industry standard is or what a "clinically significant" level would be. The insufficiency of this claim was reflected in Plaintiffs argument on this claim, in which they added nothing to flesh out the cursory treatment given to this claim in the Complaint; Plaintiffs stated only that they "charge" this level was "too high" and that Defendants committed a material omission by not telling investors that it was.

In addition, Plaintiffs put forth an argument that the alleged misrepresentations of the safety of Niaspan relate to "flushing" episodes, a side effect of niacin treatment described as characterized primarily by facial redness and tingling, often accompanied by rash. These allegations were not included in the Complaint; in the interests of fairness, the Court will consider these as an attempt to amend the claim of misrepresentation to add a claim that material misrepresentations were made about "flushing" and tolerability of Niaspan. For the same reasons that the liver toxicity claim is a wholly unsupported, unexplained and conclusory allegation that is legally insufficient when viewed in the context of the entirety of the Prospectus, the claim relating to flushing does not state a claim under Section 11.

c. *Dosage Tolerability*

Plaintiffs state that "[c]ontrary to defendants' representation, there never was any market for Niaspan and defendants knew that Niaspan was not a commercially viable product." ¶ 61. Although not specifically cited in the Complaint, the relevant section of the Prospectus states:

> Niaspan is the first once-a-day formulation of niacin approved by the FDA for the treatment of mixed lipid

> disorders... In addition, Niaspan is the only patient-friendly lipid-altering product that moves all of the major lipid components in the proper direction. Niaspan had been approved for the following indications: (i) to reduce elevated total cholesterol, low-density lipoprotein ("LDL") cholesterol, and apoliprotein B; (ii) to reduce elevated total and LDL cholesterol when used in combination with a bile-acid binding resin; (iii) to reduce elevated serum triglycerides; (iv) to reduce the risk of recurrent nonfatal myocardial infarction; (v) to promote the regression or slow the progression of atherosclerosis when used in combination with a bile-acid binding resin.

At 3.

More specifically the Prospectus states that percentage changes from baseline, quoted above in the discussion of ability to "move lipids in the right directions," are based on "intent-to-treat population at 2,000 mg Once-A-NightTM." At 25. In explaining the three-week starter packs, the Prospectus explains that the sample packs will consist of increasing tablet dosage strengths for the first three weeks of titration therapy; at the end of the three-week phase, the initial prescription will consist of a 1000 mg dose for the next four weeks; then based on physicians' recommendations, patients are expected to titrate to higher dosages of up to 2000 mg per day based on therapeutic response and tolerability. At 26.

Plaintiffs assert that even assuming that the claimed medical effectiveness was in any way true, the 2000 mg per day dose upon which the results are based could be tolerated by only a "tiny fraction" of the market and that the studies using a 2000 mg dose were "rigged" to include only those individuals who had an unusually high tolerance. ¶ 63. Further, Plaintiffs state that at a lower dose of 1000 mg daily, Niaspan is virtually ineffective, reducing total cholesterol only 4%. ¶ 64.

While we agree with Plaintiffs that FDA approval does not preclude a plaintiff from bringing a claim, *cf. Goodlin v. Medtronic, Inc.*, No. 97-5801, 1999 WL 77205 (11th Cir. Feb. 18, 1999), conclusory allegations alone will not survive a motion to dismiss. *See Glassman v. Computervision Corp.*, 90 F.3d 617, 629 (1st Cir. 1996) (noting it is "plaintiff's responsibility to plead factual allegations, not hypotheticals" that are sufficient to reasonably allow the inference of actions violative of federal securities law). Plaintiffs do not dispute that Niaspan is approved by the FDA for the treatment of mixed lipid disorders. Compl., ¶ 39. They offer no specific reasons why the language of the Prospectus that sets forth the regulatory approval process that includes extensive clinical trials and investigation should be discounted. Nor do they present any reasons why the clinical results included in the FDA-approved, publicly-available package insert are questionable. No basis or explanation for these claims is stated in the Complaint; at argument, Plaintiffs' only explanation offered was that there has to be some reason that "why physicians don't prescribe it." Plaintiffs ask the Court to infer from facts not presented that individuals cannot tolerate the dosage that was approved for use in the trials, that the Prospectus and the underlying studies openly relied on a dosage that cannot in actuality be tolerated by patients, and that the studies were "rigged" to include only people with a predetermined unusually high tolerance for Niaspan. We find that this is not legally permissible or sufficient.

2. Sales Claims

a. Misrepresentations

Plaintiffs claim that the Prospectus affirmatively misrepresented sales volume figures by quoting revenue figures of $1.5 million for the quarter ending September 30, 1997 that (1) were simply false, or (2) were accurate as to the

amount of Niaspan "sold" but based on channel-filling, and therefore was a material misrepresentation. The Prospectus states that the Company began shipping to wholesalers in mid-August 1997 and began detailing to physicians in September 1997. As to Niaspan sales, it states that "[b]ased on preliminary, unaudited financial information, the Company estimates that during its fiscal quarter ended September 30, 1997, it had revenues of approximately $1.5 million and it incurred a net loss that was significantly higher than in previous quarters primarily due to increased expenses in connection with the launch of Niaspan." At 18. On November 12, 1997, Kos filed a Form 10Q for the quarter ending September 30, 1997, stating "the Company recorded its initial product sales of $1.5 million" and issued a press release that stated the same. ¶ 55, 56.

Plaintiffs allege that as of the date the Prospectus was issued, actual Niaspan sales were "well below" $1.5 million because these reported sales were sales resulting from initial stocking (not from specific prescriptions filled) thus were materially misleading, based on "direct marketing" language in the Prospectus; for example, Plaintiffs cite to the section entitled "Marketing Strategy," which states that "[t]he Company intends to market Niaspan directly to the specialist physicians within the cardiovascular market." ¶ 58. In essence, Plaintiffs seem to argue that language in the Prospectus led investors to believe that sales would be reported only when prescriptions were filled. This section also states that physicians will be given three-week sample starter packs at no cost, and these will not be recognized as prescriptions. At 26. Plaintiff relies on figures from the Uhl Report stating that as of October 3, 1997, Kos had filled only 562 prescriptions with $30 of revenue per prescriptions and at that rate, "Niaspan would generate approximately $1.186 million of annual revenue." ¶ 59. Plaintiffs do not provide any support for the assertions that the $1.5 million figure is an inaccurate reporting of sales to

wholesalers. Kos' financial statements and filings were certified by Arthur Anderson LLP as in accordance with generally accepted accounting principles (GAAP). At no time have Kos' financials for the quarter ending September 31, 1997, or for any other time period, been restated.

b. *Omissions*

At oral argument, Plaintiffs further refined the sales claim to now state a specific material omission claim.[21] Plaintiffs allege that at the time the Prospectus was published and the Offering was held, Defendants knew the early data on the low volume of prescription sales; when this information was reported in the Uhl Report, the "truth" about the commercial non-viability of Niaspan was disclosed. Therefore, Plaintiffs allege that there was a material omission of information regarding actual prescription sales of Niaspan in its first six weeks on the market (the six weeks preceding the Offering) that Defendants were required to include in the Prospectus to make the reported preliminary revenue figures not misleading, but did not include. We find that this claim is insufficient as a matter of law because Plaintiffs have not stated a material omission.

Information is "material" if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed as having significantly altered the 'total mix' of information made available." *Basic v. Levinson*, 485 U.S.

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[21] The Complaint contains a boilerplate material omissions language, but that was only at argument that Plaintiffs clearly stated that not including prescription sales information in the portions of the Prospectus that discussed sales volume amounted to a material omission. In the interests of justice, the Court will review the sufficiency of this essentially amended claim.

224, 231-32 (1988) (citations omitted). In the securities law context, "the mere fact that an investor might find information interesting or desirable is not sufficient to satisfy the materiality requirement." *Cooperman v. Individual, Inc.*, 171 F.3d at 49 (citing *Milton v. Van Dorn Co.*, 961 F.2d 965, 969 (1st Cir. 1992)). The question of the "materiality" of an omission is usually fact-specific and particularly appropriate for jury determination. *See In re Stac*, 89 F.3d at 1405. However, where "the adequacy of the disclosure or the materiality of the statement is so obvious that reasonable minds could not differ," it is appropriate for the Court to resolve these issues as a matter of law. *See Fecht v. Price Co.*, 70 F.3d 1078, 1080-81 (9th Cir. 1995), *cert. denied*, 517 U.S. 1136 (1996). Moreover, "where the relationship between the nonpublic information that plaintiffs claim should have been disclosed and the actual results or events that the undisclosed information supposedly would have been presaged will be so attenuated that the undisclosed information may be deemed immaterial as a matter of law." *Shaw*, 82 F.3d at 1211. Information is not by definition material because it later is considered relevant to events that negatively affect the company. *Cf. Serabian v. Amoskeag Bank Shares*, 24 F.3d 357, 367 (1st Cir. 1994) (finding statements in securities fraud case non-actionable under Rule 9(b) where claim was based on "the assumption that the defendants must have known of the severity of their problems earlier because conditions became so bad later."). Lastly, although there is a strong affirmative duty of disclosure in the context of public offerings, "it is clear that an issuer of securities owes no absolute duty to disclose all material information." *Cooperman*, 171 F.3d at 50-51 (further citing *Backman v. Polaroid*, 910 F.2d 10, 16 (1st Cir. 1999), for the proposition that although voluntary, material disclosures must be "complete and accurate," that "does not mean that by revealing one fact about a product, one must reveal all others that, too, would be interesting market-wise.").

Considering the totality of the circumstances, Plaintiffs have not sufficiently alleged a material omission in the Complaint before us. We find that the materiality of this information is highly questionable, if not absent, given the context and preliminary nature of this data. First, it is necessary to consider the Prospectus itself. Plaintiffs cannot dispute that the Prospectus is replete with statements about Niaspan's uncertainty of market acceptance (by either physicians or patients), large number of competitors and rapid pace of technological change and development, as well as Kos' limited sales and market experience, limited number of sales persons (fewer than competitors), and limited resources necessary to promote Niaspan. Prospectus at 6-12. The specific prescription sales figures that may have been available at the time of the Offering are not reported in the Prospectus. Defendants point out that reporting such incomplete and potentially inaccurate information is neither required nor prudent under Section 11.

Second, we note that the Report states that the revised revenue estimates are based on projections from the *eighth week* of prescription sales, the week ending October 31, 1997, which took place *after the Offering*. Ex. 4 at 2, Kos Mem. ("According to IMS data, 708 new prescriptions (NRx's) and 760 total prescriptions (TRx's) were filled for Niaspan in the week ending October 31, the eighth week data is available. At this rate of 760 TRx's per week, Niaspan would generate approximately $1.186 million of annual income."). As of the date of the Offering, only six-and-a-half weeks of sales had transpired. Thus, the relevant week for the analyst considered it reasonable to rely on in making a projection had not even occurred when the Prospectus was filed and the Offering held.

Third, if we were to assume that data from previous weeks, though not relied on specifically in the Uhl Report, also would have been material, the Uhl Report relies on

data received from an independent source that monitors such prescription sales. Plaintiffs have not indicated the type of preliminary sales information that Defendants had, but assuming for the purposes of this Motion that Defendants had the IMS America data that Plaintiffs cite, it was possible for Defendants to have data from only a limited number of weeks. Given that the Report analyzing this data was published November 12, 1997, eleven days after the close of Week 8, it appears that however the information would be received, there would be some delay as well between the close of a sales week and the availability of sales information that means less than six-and-a-half weeks of data would have been available as of the Offering.

Plaintiffs argue that Defendants should have recognized the trend of low prescription sales in earlier weeks and immediately alerted investors by including preliminary prescription sales information as soon as it was available to Kos. Assuming for the purposes of this Motion that Plaintiffs could adduce adequate evidence that the Defendants were actually in possession of several weeks of prescription information at the time of the Offering, such conclusory allegations of materiality and duty to disclose are not sufficient to state a claim. *Compare Shaw*, 82 F.3d at 1194 (denying motion to dismiss where "the issuer is in possession of nonpublic information indicating that the quarter in progress at the time of the public offering will be an extreme departure from the range of results which could be anticipated based on currently available information and past quarter performances). Defendants inclusion of preliminary, unaudited September revenue figures in the Prospectus does not necessarily create an obligation to report *all information that an investor might consider relevant* to considering those figures. *See Cooperman*, 171 F.3d at 51. To require Defendants to disclose the initial prescription sales information simply because later prescription sales information led to a revised rating, which led to a stock drop, is to impose a materiality requirement

and a duty to disclose, therefore liability, based on hindsight. *Cf. Serabian v. Amoskeag Bank Shares*, 24 F.3d at 367 (in securities fraud action, rejecting claim that because eventual results were so negative, defendants must have known of the serious nature of their problems early on).

We emphasize that the context of this Offering and this company, as thoroughly explained in the Prospectus, is crucial - this is a company advancing out of a development-only stage into a marketing and sales stage for the first time in September 1997; the company has never made a profit and has amassed large deficits; the company admits to having a small sales force and limited resources; Niaspan, the sole product, is an unproven treatment, the success of which hinges on patient and physician acceptance; initial product use will be based on three-week samples that will not be recorded as prescriptions. Considering the entirety of the circumstances, we find that the allegedly undisclosed information is sufficiently remote in causation and in time from the ultimate events that supposedly revealed the "truth" that as a matter of law Plaintiffs do not state a claim.

B. Section 12(a)(2)

Plaintiffs claims under Section 11 (registration statement) and Section 12(a)(2) (prospectus or oral communication) rely on the statements included in the Prospectus indicated above. Because we have found that Plaintiffs has not sufficiently alleged material misrepresentations or omissions, under Section 12(a)(2), the claim must fail.[22]

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[22] Because we dismiss this claim in its entirety, we do not need to address the question of whether a claim can be stated against all of the named Defendants as "sellers" under Section 12(a)(2). *See Pinter v. Dahl*, 486 U.S. 622 (1988).

C. Section 15

Because the claims under Section 11 and Section 12(a)(2) are dismissed, there is no basis for asserting a primary violation under the 1933 Act. Therefore, the Section 15 claim based on "control person" liability is dismissed as well.

IV. Analysis of Claims Alleging Violations of Section 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 - Counts IV and V

Based on same allegations underlying the 1933 Act claims, Plaintiffs argue that Defendants violated Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) [hereinafter "Section 10(b)"], and 17 C.F.R. § 240.10b-5 [hereinafter "Rule 10(b)-5"], by failing to disclose material facts and making false statements in the medical claims and sales claims made regarding Niaspan.

A. Section 10(b) and Rule 10b-5 Claim

1. Applicable Legal Standards

Section 10(b) makes it unlawful for any person "[t]o use or employ, in connection with the purchase or sale of any security... any manipulative or deceptive devices or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." 15 U.S.C. § 78j(b). Rule 10b-5 prohibits the making of any untrue statement of material fact or the omission of a material fact that would render statements made misleading in connection with the purchase or sale of any security. *See* 17 C.F.R. § 240.10b-5. To successfully state a securities fraud claim under Rule 10b-5, a plaintiff must show the following: (1) a misstatement or omission; (2) of a material fact; (3) made with scienter; (4) on which the plaintiff relied; (5) that proximately caused

his injury. *See Ross v. Bank South, N.A.*, 885 F.2d 723, 728 (11th Cir. 1989) (en banc), *cert. denied*, 495 U.S. 905 (1990).

In order to survive a motion to dismiss, Plaintiffs' claim of fraud under Rule 10b-5 must also satisfy the requirements of Federal Rule of Civil Procedure 9(b), which requires that the "circumstances constituting fraud ... must be stated with particularity." *See e.g., Gross v. Medaphis Corp.*, 977 F. Supp. 1463, 1470 (N.D. Ga. 1997). Rule 9(b) will be satisfied if the Complaint sets forth what statements or omissions were made in what documents or oral representation; the time and place of the statements or omissions; who made the statements; the content of the statement and the manner in which they misled the plaintiffs; and what the defendant "obtained as a consequence of the fraud." *Brooks v. Blue Cross and Blue Shield of Florida, Inc.*, Case No. 95-405-CIV-SM (S.D. Fla. 1995), aff'd on other grounds, 116 F.3d 1364, 1369 (11th Cir. 1997).

Furthermore, the Private Securities Litigation Reform Act of 1995, Pub. L. No. 194-67, 109 Stat. 743, codified at 15 U.S.C. § 78u-4(b) [hereinafter "Reform Act"], establishes heightened pleadings requirements for certain private securities actions. If these additional requirements are not met, the Court shall dismiss the action. 15 U.S.C. § 78u-4(b)(3). Section 78u-4(b) imposes two requirements. First, the plaintiff must specify each statement alleged to have been misleading and the specific reason or reasons why such statement is misleading. 15 U.S.C. § 78u-4(b)(1).[23]

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[23] Section 78u-4(b)(1) states:

> In any private action arising under this title in which the plaintiff alleges that the defendant –
>
> (A) made an untrue statement of a material fact; or
>
> (B) omitted to state a material fact in order to make the

(continued...)

This provision requires pleading with particularity all facts upon which the plaintiff is basing the fraud allegation, thus is even more specific than the Rule 9(b) standard. *Malin*, 17 F. Supp. 2d at 1361. Second, the would-be plaintiff, for each alleged misrepresentation, must indicate those specific facts that give rise to a "strong inference" that Defendant acted with scienter.

2. Analysis of Allegations on Section 10(b) and Rule 10(b)-5 Claims

Plaintiffs claim that Defendants made false and materially misleading statements and omissions in violation Section 10(b) and Rule 10(b)-5.[24] In accordance with the requirements for bringing a claim under Rule 10(b)-5, Plaintiffs have alleged that Defendants made misstatements and/or omissions of material fact, with scienter, in connection with the purchase of securities, upon which Plaintiff relied, and that reliance proximately caused Plaintiff's injury. Plaintiffs also maintain that they have

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[23] (...continued)

> statements made, in the light of the circumstances in which they were made, not misleading;
>
> the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

[24] The statutory safe harbor for "soft" projections is not applicable here because Plaintiffs' allegations concern defendants' liability for "statements that misrepresent historical/hard or current facts." *Gross v. Medaphis Corp.*, 977 F. Supp. 1463 (N.D. Ga. 1997).

stated with particularity the circumstances constituting fraud as required by Fed. R. Civ. P. 9(b). In short, Defendants argue that this case should be dismissed for failure to state a claim upon which relief can be granted on numerous grounds including lack of misstatement or omission, lack of facts giving rise to strong inference of scienter, lack of facts on loss causation and reliance, lack of particularity of fraudulent conduct. Because Plaintiffs' claims failed based on the two grounds discussed below, we do not find it necessary, and therefore decline, to address the additional arguments.

In regard to the Section 11 claims, we held that Plaintiffs have not met the standard of stating a claim of material misrepresentations where no element of scienter is required to be pled. Accordingly, upon consideration of the additional allegations regarding press releases and SEC filings, it remains clear that the 1934 Act claims must fail because they do not state an actionable misstatement or omission. Furthermore, the heightened pleading requirements of pleading with particularity facts giving rise to a strong inference of scienter simply are not met on these facts. Specifically, Defendants argue that the statements made in the Prospectus, the July 29, 1997 press release, and the SEC Form 10Q filing, are good faith representations of the knowledge Defendants possessed at the time the statements were made. They further maintain that they were not material misrepresentations, and remain uncontradicted to this date. We find that Plaintiffs have not pled sufficient facts giving rise to a strong inference of recklessness or knowing misconduct in making the statements that were made regarding either the medical claims or the sales claims.

B. Section 20(a) Controlling Persons Liability

Section 20(a) of the Exchange Act provides that "every person who, directly or indirectly, controls any person liable

under any provision of this chapter or any rule or regulation thereunder shall be liable jointly and severally with and to the same extent as such controlled person." Because Plaintiffs' Section 10(b) and Rule 10b-5 claims fail and the substantive securities fraud claims are dismissed, the motion to dismiss the Section 20(a) claims must be granted.

V. Pendent State Law Claims - Counts VI, VII, and VIII

In light of the fact that no federal claims survive the Motion to Dismiss, the Court declines to exercise jurisdiction over the remaining Counts pled under state law.

VI. Dismissal of the Action with Prejudice

In dismissing this action in its entirety, we have found that Plaintiffs claim is inadequate as a matter of law and that, as pled, Plaintiffs can prove no set of facts in support of their claims which would entitle them to relief. See *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). Leave to amend shall be granted, however, "when it appears that a more carefully drafted complaint might state a claim upon which relief could be granted." *Friedlander v. Nims*, 755 F.2d 810, 813 (11th Cir. 1985) (citing *Conley*, 355 U.S. 41). The case shall be dismissed with prejudice, however, where "the court determines that the allegation of other facts consistent with the challenged pleading could not possibly cure the deficiency." *Plevy v. Haggerty*, No. CV 97-9200, 1998 WL 951694 (C.D. Cal. Aug. 21, 1998) (dismissing securities fraud suit with prejudice); *Glassman v. Computervision* Corp., 90 F.3d 617, 623 (1st Cir. 1996) (holding that where no amendment would state a claim, dismissal may be granted with prejudice); *Rhodes v. Omega Research*, Inc., No. 98-0174-CIV-LENARD, 1999 WL 115488, *9 (S.D. Fla. Mar. 1, 999) (dismissing with preju-

dice claims that are "futile" and could not be repled to state a cause of action under Section 11 or 12).

In this case, we find that the deficiencies in Plaintiffs' claims cannot be cured. As to the medical claims, Plaintiffs presented only conclusory allegations of misrepresentations, did not challenge or contradict any of the FDA-approved studies or cited results, and indicated that they would not be able to provide any more specific allegations without the Court lifting the discovery stay to provide access to Defendants documents and files. In pleading and arguing the sales claims, Plaintiffs do not refute the quarterly revenues reported in the Prospectus, the press releases, and in public SEC filings that provided the basis of the misrepresentation claim. In bringing the claim that the prescription sales information was a material omission, Plaintiffs argue only that this interim internal information was necessary to understand the above revenue figures that have never been restated. As stated above, we find that no reasonable investor could have been misled based on these alleged misrepresentations and omissions, and thus the claims must be dismissed. In light of the facts that Plaintiffs initially filed this action in August 1998; that Plaintiffs have had notice of the possibility of dismissal of this action since the motions to dismiss were filed in January 1999; and that Plaintiffs counsel has indicated that there is no further information that could be gathered to further specify the allegations of this Complaint, the Complaint is hereby dismissed with prejudice.

VII. Conclusion

For the reasons stated above, it is hereby ORDERED AND ADJUDGED that the Kos Defendants' Motion to Dismiss (DE#5) and the Underwriter's Motion to Dismiss (DE#18) are GRANTED. This Case is DISMISSED WITH PREJUDICE.

It is further ORDERED AND ADJUDGED that this Case is CLOSED and all pending Motions are DENIED AS MOOT.

DONE AND ORDERED in Chambers at Miami, Florida this 19th day of May, 1999.

/s/
DONALD M. MIDDLEBROOKS
UNITED STATES DISTRICT JUDGE

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

OXFORD ASSET MANAGEMENT, et al.	)	
	)	
	)	
	)	No. 98-2972
v.	)	
	)	[Filed Jan 31, 1999]
	)	
KOS PHARMACEUTICALS, et al.,	)	
	)	

ORDER GRANTING MOTIONS FOR SANCTIONS

This Cause came before the Court upon the Kos Defendants' Motion for Entry of Final Judgment, for Mandatory Review under the Reform Act and for the Imposition of Sanctions, filed July 6, 1999 (DE#51), and the Underwriter Defendants' Motion for Mandatory Review Under the Reform Act and for the Imposition of Sanctions, filed July 16, 1999 (DE#54). In this Order, the Court addresses Defendants request that the Court review the record, as mandated by the Private Securities Litigation Reform Act ("the PSLRA"), 15 U.S.C. § 77z-1(c)(1) (the Securities Act of 1993) and 15 U.S.C. § 78u-4(c)(1) (the Securities Exchange Act of 1934)[1], to determine whether Plaintiffs are subject to

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[1] The PSLRA places significant limitations and requirements on private actions brought under the Securities Act of 1933 and the Securities Exchange Act of 1934. *See* Martha L. Cochran, *Overview and Summary of the Private Securities Litigation Reform Act*, PRAC. L. INST., Feb.-Mar. 1996, at 11. The Court cites provisions

(continued...)

sanctions under Federal Rule of Civil Procedure 11(b). In ruling upon this Motion the Court has reviewed the file, including the following pleadings, and is otherwise fully informed in the premises: Plaintiffs' Complaint, transferred from the Northern District of Illinois; Defendants' above-referenced motions for review and for sanctions under the PSLRA; Plaintiffs' Response to Motions for Sanctions (DE#6)); the Kos Defendants' Reply (DE#65); and the Underwriter Defendants' Reply (DE#66).

I. Background

Plaintiffs brought a securities class action on behalf of those individuals who purchase Kos stock between July 29, 1997 and November 13, 1997, including those individuals who purchased common stock in a secondary public offering on October 24, 1997, as well as those who purchased common stock on the open market during the class period. Plaintiffs stated claims under §§ 11, 12(a)(2), and 15 of the Securities Act of 1993, 15 U.S.C.§§ 77k, 771(a)(2), and 77o, and §§ 10(b) and 20(a) of the Exchange Act of 1934, 15 U.S.C. §§ 78j and 78t(a) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240-10b-5, as well as common law fraud and negligent misrepresentation. As Defendants, Plaintiffs named Kos, its individual officers and directors at the time of the secondary offering, and the investment banking firms that underwrote the secondary offer.

The parties break Plaintiffs' claims down into two categories: claims arising from omissions and/or misstatements

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[1] (...continued)
of both Acts in recognition that Plaintiffs raised claims under both Acts

related to the sales volume of Niaspan[2] ("sales claims"); and claims arising from misstatements and/or omissions related to Niaspan's safety and efficacy ("medical claims").

In support of their sales claims, Plaintiffs contended that at the time of the secondary offering, Defendants knew that Niaspan's sales in the first seven weeks after its introduction were dismal and far below the sales expectations that supported the secondary offering price, yet omitted this information from the prospectus ("the Prospectus") and registration statement it filed with the Securities and Exchange Commission, thereby misleading the investing public.[3] Plaintiffs also maintained that Kos misrepresented the sales volume for Niaspan in the Prospectus by reporting sales of $1.5 million worth of Niaspan in the fiscal quarter ended September 30, 1997. The $1.5 million was the value of Niaspan that Kos shipped to wholesalers. According to Plaintiffs, the most natural reading of the Prospectus would lead one to conclude that the $1.5 million figure represented sales directly to physicians, which only generated $16,860 of revenue for the quarter ended September 30, 1997.

Plaintiffs' medical claims contended that Niaspan was not as safe or effective as Defendants represented in the Prospectus. Specifically, Plaintiffs alleged that Niaspan could not increase high density lipoprotein cholesterol by the amounts claimed in the Prospectus and that when

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[2] Niaspan is an FDA-approved drug for the treatment of "mixed lipid disorders" and the only product Kos had on the market during the relevant period.

[3] As the Court pointed out in the order dismissing this case, Plaintiffs did not clearly raise this theory until oral argument. Nonetheless, we considered the theory as an "essentially amended claim" in examining the sufficiency of the Complaint. Order at 21 n.21.

taken in the dosage required for it to be effective, Niaspan was "intolerable." Plaintiffs also claimed that Kos "skewed" its clinical trials by selecting a population that was predetermined to have an unrepresentatively high tolerance to Niaspan.

By order entitled Order Granting Motion to Dismiss ("the Order"), dated May 19, 1999, the Court granted Defendants' Motions to Dismiss Plaintiffs' Complaint (DE#44). The instant motions for sanctions followed.

II. Rule 11 sanctions under the PSLRA

Congress enacted the PSLRA to curtail abusive securities litigation, whereby plaintiffs bring meritless claims, hoping to initiate discovery that might uncover evidence that was not alleged in the complaint. *See Smith v. Smith*, 184 F.R.D. 420, 422 (S.D. Fla. 1998). To that end, the PSLRA has stringent pleading requirements, requiring particularized facts to substantiate allegations, and imposes an automatic stay of discovery while courts determine the legal sufficiency of complaints. *See* 15 U.S.C. § 78u-4(b)(1),; 15 U.S.C § 78u-4(b)(3)(B), 15 U.S.C. § 77z-1(b)(1).

In addition, as a further check on meritless securities claims, upon final adjudication of any action arising under federal securities law, the PSLRA mandates that "the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion." 15 U.S.C. § 77z-1(c)(1); 15 U.S.C. § 78u-4(c)(1). Should a court find a violation of Rule 11(b) pursuant to paragraph (1), "the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure." 15 U.S.C. § 77z-1(c)(2); 15 U.S.C. § 78u-4(c)(2). "[F]or substantial failure of any complaint to comply with any

requirement of Rule 11(b) of the Federal Rules of Civil Procedure" the court shall adopt a presumption that the appropriate sanction "is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action." 15 U.S.C. § 77z-1(c)(3)(ii); 15 U.S.C. § 78u-4(c)(3)(ii).

Rule 11 sanctions are proper "(1) when a party files a pleading that has no reasonable factual basis; (2) when the party files a pleading that is based on a legal theory that has no reasonable chance of success and that cannot be advanced as a reasonable argument to change existing law; or (3) when the party files a pleading in bad faith for an improper purpose."[4] *Worldwide Primates, Inc. McGreal*, 87

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[4] Rule 11(b) of the Federal Rules of Civil Procedure provides, in pertinent part, as follows

> By presenting to the court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,—
>
> (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
>
> (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
>
> (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery . . . .
>
> If a court determined that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that

(continued...)

F.3d 1252, 1254 (11th Cir. 1996) (quoting *Jones v. International Riding Helmets, Ltd.*, 49 F.3d 692, 694 (11th Cir. 1995)). Under Eleventh Circuit law, a court confronted with a Rule 11 motion for sanctions "first determines whether the non-movant's claims are objectively frivolous - in view of the facts or law - and then, if they are, whether the person who signed the pleadings should have been aware that they were frivolous; that is, whether he would have been aware had he made a reasonable inquiry." *Worldwide Primates*, 87 F.3d at 1254; *see also Baker v. Alderman*, 158 F.2d 516, 524 (11th Cir. 1998). Where there is no direct evidence available and ask, objectively, whether an ordinary person standing in the party's or counsel's shoes would have prosecuted the claim. *See Pelletier v. Zweifel*, 921 F.2d 1465, 1515 (11th Cir. 1991). Rule 11 sanctions are reserved for only exceptional circumstances. *See Mary Ann Pensiero, Inc. v. Lingle*, 847 F.2d 90, 99 (3rd Cir. 1988).

The PSLRA does specifically require courts to conduct a Rule 11 inquiry in the securities litigation context, but it "does not in any way purport to alter the substantive standards for finding a violation of Rule 11." *Simon DeBartolo Group, L.P. v. Richard E. Jacobs Group, Inc.*, 186 F.2d 157, 167 (2d Cir. 1999). It functions "merely to reduce courts' discretion in choosing whether to conduct the Rule 11 inquiry at all and whether and how to sanction a party once a violation is found." *Id.*

III. Analysis

The Court agrees with Plaintiffs that they are not subject to Rule 11 sanctions simply because their claims were

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[4] (...continued)
have violated subdivision (b) or are responsible for the violation. Fed. R. Civ. P. 11(c).

dismissed. *See, e.g., Brubaker v. City of Richmond*, 943 F.2d 1363, 1367 (4th Cir. 1991). The Court also agrees with Plaintiffs that sanctions are not warranted in this case on the grounds that Plaintiffs proffered frivolous legal arguments, unwarranted by existing law. *See, e.g., Fecht v. Price Co.*, 70 F.3d 1078, 1080 (9th Cir. 1995) (overturning dismissal of securities claims that alleged material omission and misleading statements). Moreover, the Court is satisfied that, for the most part, Plaintiffs conducted a thorough investigation before filing their claims. Instead, the Court finds that Plaintiffs are subject to Rule 11 sanctions because their allegations and other factual contentions were without evidentiary support and because evidentiary support was unlikely to be turned up by further investigation or discovery. *See* Fed. R. Civ. P. 11(b)(3). In short based on the evidence uncovered by their investigation, Plaintiffs should not have commenced this action.[5]

Plaintiffs point out in their responsive pleading that Rule 11 sanctions are not warranted based on the fact that a complaint was vague or conclusory. Plaintiffs' Resp. to Mots. for Sanctns., p. 16 (citing *Simpson v. Welch*, 900 F.2d 33, 35 (4th Cir. 1990). They also point out that Rule 11 sanctions are not appropriate where a plaintiff's evidence is merely weak. Id. (citing *Alderman*, 158 F.3d at 524; *Davis v. Carl*, 906 F.2d 533, 537 (11th Cir. 1990)). These cases, however, stand for the limited proposition that sanctions do not automatically follow where these shortcomings are apparent in the complaint. Sanctions are still

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[5] That Plaintiffs consulted experts who supported Plaintiffs' claims does not shield Plaintiffs from sanctions, for the Court is not sanctioning Plaintiffs for relying on the conclusions of their experts. Rather, the Court sanctions Plaintiffs for making the legal determination that what evidence Plaintiffs gleaned from the experts and other investigation provided a factually sufficient basis for filing this lawsuit.

appropriate where such complaints are not well grounded in fact. *See Welch*, 900 F.2d at 36 ("Even a vague and conclusory complaint may be 'well grounded in fact and . . . warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law."); *Alderman*, 158 F.3d at 524 ("Although sanctions are warranted when the claimant exhibits a 'deliberate indifference to obvious facts,' they are not warranted when the claimant's evidence is merely weak but appears sufficient, after a reasonable inquiry, to support a claim under existing law.") In bringing their claims, Plaintiffs demonstrated a deliberate indifference to their lack of factual support.

For the reasons set forth below, the Court finds that in view of the facts presented in Plaintiffs' Complaint and at oral argument on Defendants' motions to dismiss, Plaintiffs' claims were objectively frivolous and counsel for Plaintiffs should have been aware when signing off on the Complaint that it was factually deficient.[6]

1. Medical claims

Plaintiffs alleged that Defendants made misrepresentations as to Niaspan's effectiveness, safety, and dosage tolerability.

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[6] The Court reviews Plaintiffs' claims separately in recognition that under the PSLRA Defendants can only recover attorneys' fees and costs—the presumptive sanction under the PSLRA—incurred litigating frivolous claims. If, for example, the Court only deems one of the claims sanctionable, Defendant cannot recover the fees and costs incurred litigating the entire action. *See Simon DeBartolo*, 186 F.3d at 178; *Inter-County Resources, Inc. v. Medical Resources, Inc.*, 49 F. Supp.2d 682, 683 (S.D.N.Y. 1999).

a. Effectiveness

Plaintiffs allege that Kos misrepresented the extent to which Niaspan could "move" lipid measures in the "right direction" by contrasting the Prospectus with a July 1997 press release and a 1996 article discussing a trial of Niaspan that Kos sponsored. As the Court pointed out in its Order, the figures reported in the Prospectus are consistent with the figures in the press release and article. Order at 15. Plaintiffs also alleged that they had not seen other studies referred to in the Prospectus so could not be sure that the Prospectus did not misrepresent the studies' findings. At oral argument, however, Plaintiffs conceded that it was "very possible" that Defendants were "right" about the figures cited in the Prospectus, but that they could not confirm this because they had not reviewed all the studies. In sum, Plaintiffs offered no evidence that supported their claim that Defendants misrepresented the effectiveness of Niaspan. The Court rightfully characterized this claim as characteristic of the "fishing expeditions" the PSLRA was designed to curtail.

b. Safety

In the Prospectus, Kos represented that "[o]f all patients treated with Niaspan in the pivotal and long-term safety trials, only four patients with normal liver function tests at baseline showed clinically significant elevations in liver function tests (defined as elevations greater than three times the upper limit of normal) during treatment with Niaspan." Cmplt. at ¶ 50. Plaintiffs contended that the above statement "misrepresented the industry standard as to what constitutes tolerable and safe levels of liver toxicity." *Id.* at 51. In contrast to Kos's claim in the Prospectus, Plaintiffs alleged that "Niaspan use elevated liver toxicity to an intolerable and unsafe level." *Id.* As the Court pointed out in dismissing this claim, Plaintiffs cited

no facts and provided no explanation for this assertion. Order at 17. "In addition to failing to provide any support or authority for these assertions, Plaintiff does not even state what the industry standard is or what a 'clinically significant' level would be." *Id.*

Plaintiffs also claimed that Kos made misrepresentations about "flushing episodes," a side effect of niacin treatment. The Court considered this claim in ruling on the motion to dismiss even though the allegation was not part of the Complaint, finding that it was "a wholly unsupported, unexplained and conclusory allegation that is legally insufficient when viewed in the entirety of the Prospectus." *Id.* at p. 18.

As the above demonstrates, the safety claims were not well grounded in fact.

c. Dosage intolerability

Plaintiffs claimed that the dosages at which Niaspan would have to be ingested to be effective were intolerable to most of the market and that studies in which such levels were used were "rigged" to include only those individuals who had an unusually high tolerance. Cmplt. at ¶ 63.

In dismissing this claim, the Court found it to be a conclusory allegation. it was also devoid of factual support, as the Order points out:

> Plaintiffs do not dispute that Niaspan is approved by the FDA for the treatment of mixed lipid disorders. They offer no specific reasons why the language of the Prospectus that sets forth the regulatory approval process that includes extensive clinical trials and investigation should be discounted. Nor do they present any reasons why the clinical results included in the FDA-approved, publicly-available package insert are questionable. No

> basis or explanation for these claims is stated in the Complaint; at [oral] argument [on the motion to dismiss], Plaintiffs' only explanation offered was that there has to be some reason that (sic) why physicians don't prescribe it.

Order at 19. The Court refused to infer the sufficiency of these claims "from facts not presented." *Id.*

2. Sales claims

a. Misrepresentations

Plaintiffs characterized the $1.5 million sales volume figure reported in the Prospectus as either false or misleading. False because Plaintiffs figured that direct sales were well below $1.5 million. Misleading because in actuality the figure related to wholesale sales, while in Plaintiffs' opinion, the "direct market" language in the Prospectus suggested the figure referred to direct sales to physicians. Cmplt. at ¶ 58.

Plaintiffs provided no evidence that $1.5 million falsely reflected wholesale sales. As concerns their claim that the figure was misleading, Plaintiffs provided no evidence other than to characterize the sales to wholesalers as "filling the pipeline," which it claimed was contrary to the Prospectus's representation that Kos intended to market Niaspan directly to physicians. *Id.* The very portion of the Prospectus Plaintiffs quoted, however, demonstrates that this claim, too, was not well grounded in fact: just a few lines above where the Prospectus estimates sales for the quarter ended September 30, 1997 at $1.5 million, it states that "[t]he company began shipping Niaspan to wholesalers in mid-August 1997, and it began detailing Niaspan to physicians in September 1997." *Id.* at ¶ 54. As the "Marketing Strategy for Niaspan" section of the Prospectus indicates, Kos's "detailing effort" involved giving physicians

free samples of Niaspan in the form of three-week titration starter packs. Prospectus at 25 - 26. Obviously, these giveaways would not be represented in the company's sales figures. Even if "detailing" more generally describes direct sales to physicians, it would have been obvious upon reasonable investigation that if the free samples covered three weeks and if detailing did not begin until September 1997, there would not likely have been $1.5 million in direct sales to physicians for the period ended September 30, 1997.

b. Omissions

As the Court pointed out in the Order, Plaintiffs' claim that Defendants violated the securities laws by omitting from the Prospectus information regarding prescription sales of Niaspan in its first six weeks on the market was essentially an amended claim. Order at 21 n.21. The Complaint merely contains "boilerplate material omissions language." *Id.* Only at oral argument on Defendants' motions to dismiss did Plaintiffs refer to the absence of early prescription sales information. Accordingly, it is clear to the Court that this claim, only subsequently flushed out, was not well grounded in fact.[7]

---

[7] Just because, "in the interests of justice," the Court decided to entertain this "essentially amended claim" in ruling upon the motions to dismiss, does not mean that the Court has to read Plaintiffs' presentation at oral argument into the Complaint when judging whether Plaintiffs' claims were well grounded in fact. Order at 21 n.21.

IV. Conclusion

Having found that all of Plaintiffs' claims were devoid of evidentiary support for purposes of Federal Rule of Civil Procedure 11(b)(3), it is hereby ORDERED AND ADJUDGED that Defendants' Motions for Sanctions (DE#s 51 &54) are GRANTED. Further, having found that Plaintiffs' failure to comply with Rule 11(b) was substantial, Plaintiffs shall pay to Defendants a sum equal to the attorneys' fees and costs incurred by Defendants in litigating this action. See 15 U.S.C. § 77z-1(c)(3)(ii); 15 U.S.C. § 78u-4(c)(3)(ii). The amount of such payment will be determined based on the Court's review of Defendants' billing and expense records.

DONE AND ORDERED in Chambers at Miami, Florida this 31st day of January 2000.

/s/
DONALD M. MIDDLEBROOKS
UNITED STATES DISTRICT JUDGE

Copies provided to counsel of record

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

OXFORD ASSET MANAGEMENT, et al.,	)	
	)	No. 98-2972
v.	)	[Filed May 22, 2000]
KOS PHARMACEUTICALS, et al.,	)	

ORDER ON MOTION FOR FEES AND COSTS

By order dated January 31, 2000, the Court granted Defendants' ("the Kos Defendants" and "the Underwriter Defendants") motions for attorneys' fees and expenses under the Private Securities Litigation Reform Act and Fed.R.Civ.P. 11. DE#69. Finding insufficient documentation to award a specific amount at that time, the Court directed Defendants to submit billing and expense records and any other materials verifying the amounts claimed. Presently before the Court are Defendants' responsive submissions, as well as Plaintiffs' objections thereto and Defendants' replies. The Court has reviewed these materials and is otherwise fully informed in the premises.

1. Attorneys' fees

Courts determining attorney's fee awards begin by determining the "lodestar": the product of the number of

hours reasonably expended on the litigation and a reasonable hourly rate for the attorney's services. *See Hensley v. Eckerhart*, 461 U.S.424, 433 (1983); *American Civil Liberties Union of Georgia v. Barnes*, 168 F.3d 423, 427 (11th Cir. 1999); *Loranger v. Stierheim*, 10 F.3d 776, 781 (11th Cir. 1994). This lodestar may then be adjusted for the results obtained. *See Eckerhart*, 461 U.S. at 435 - 37; *Barnes*, 168 F.3d at 427; *Loranger*, 10 F.3d at 781; *Norman v. Hous. Auth. for the City of Montgomery*, 836 F.2d 1292, 1302 (11th Cir. 1988).

Upon careful review of Defendants' submissions and Plaintiffs' objections, the Court finds the hours expended and the rates charged to be reasonable and thus adopts Defendants' lodestar figures. Moreover, finding that Defendants obtained excellent results, the Court does not disrupt these figures.

Plaintiffs attack Defendants' fee requests on several grounds. First, Plaintiffs argue that entries submitted by both groups of Defendants containing redactions should be deleted as failing to meet Defendants' burden of supporting their petitions. *See Norman*, 836 F.2d at 1302 (indicating that burden on fee applicant to establish entitlement and document hours and rates). Many, if not all, of these entries contain enough information for the Court to determine that the hours were reasonably expended. Surrounding entries demonstrate that the time claimed in these entries was spent on this matter, either performing legal research or discussing the case with unidentified individuals. Second, Plaintiffs generally maintain the fees sought are not reasonable, considering that the case lasted only ten months and was dismissed on a 12(b)(6) motion. In light of the factual and legal complexities of this case, the Court finds this argument unpersuasive. Also unpersuasive are Plaintiffs' assertions that Defendants attempt to recover for unnecessary and duplicative work and failed to mitigate

their fees and expenses. Plaintiffs fail to specify any hours believed to be duplicative and their one example of unnecessary work was in response to Plaintiffs' commencement of this action. Plaintiffs' mitigation argument is simply without merit.

2. Expenses

Plaintiffs raise similar arguments in attacking Defendants' expenses. As above, this Court finds these arguments unpersuasive and Defendants claimed expenses to be reasonable.

3. Conclusion

For the foregoing reasons, the Court grants Defendants the full relief sought: **$335,686.55** in fees and expenses to the Kos Defendants and **$166,890.27** in fees and expenses to the Underwriter Defendants. Finding commencement of this action to constitute bad judgment on the part of both Plaintiffs and their counsel, the sum of **$502,576.82** shall be split 50 - 50 between them, both incurring **$251,288.41**. Having considered the Underwriter Defendants supplemental proof of fees and costs, their Motion to Permit Additional Proof of Fees and Costs (DE#79) is **GRANTED**.

DONE AND ORDERED in Chambers at Miami, Florida this 22nd day of May 2000.

/s/
DONALD M. MIDDLEBROOKS
UNITED STATES DISTRICT JUDGE

Copies provided to counsel of record

APPENDIX C: ELEVENTH CIRCUIT REHEARING ORDER IN THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

No. 99-11690-FF

OXFORD ASSET MANAGEMENT, LTD,

Plaintiff-Appellant,

v.

MICHAEL JAHARIS, DANIEL M. BELL, DUNCAN COCROFT, JUAN F. RODRIGUEZ, ROBERT E. BALDINI, et al.,

Defendants-Appellees.

No. 00-13220-FF

OXFORD ASSET MANAGEMENT, LTD., LOWEY DANNENBERG & KNAPP, P.C. PROFIT SHARING PLAN & TRUST a.k.a. Lowey Dannenberg, Bemporad & Selinger P.C. Profit Sharing Plan,

Plaintiffs-Appellants,

ARTHUR T. SUSMAN, CHARLES R. WATKINS, ROBERT J. EMANUEL, SUSMAN & WATKINS,

Interested Parties – Appellants,

v.

MICHAEL JAHARIS, DANIEL M. BELL, DUNCAN COCROFT, JUAN F. RODRIGUEZ, ROBERT E. BALDINI, et al.,

Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of Florida

BEFORE: EDMONDSON, Chief Judge, FAY and GARWOOD*, Circuit Judges.

PER CURIAM:

The Petition(s) for Rehearing are DENIED and no Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure), the Petition(s) for Rehearing En Banc are DENIED.

ENTERED FOR THE COURT:

/s/_____
CHIEF JUDGE

ORD-42

*Honorable William L. Garwood, U.S. Court of Appeals for the Fifth Circuit, sitting by designation.

APPENDIX D: TEXT OF RELEVANT STATUTES AND RULES

UNITED STATES CODE ANNOTATED
TITLE 15. COMMERCE AND TRADE
CHAPTER 2A--SECURITIES AND TRUST INDENTURES
SUBCHAPTER I—DOMESTIC SECURITIES

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Current through P.L. 108-30, approved 05-29-03

§ 77k. Civil liabilities on account of false registration statement

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue--

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by

him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Persons exempt from liability upon proof of issues

Notwithstanding the provisions of subsection (a) of this section no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof--

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the

time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document.

(c) Standard of reasonableness

In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

(d) Effective date of registration statement with regard to underwriters

If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration state-

ment shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

(e) Measure of damages; undertaking for payment of costs

The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: Provided, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the

payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) Joint and several liability; liability of outside director

(1) Except as provided in paragraph (2), all or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(2)(A) The liability of an outside director under subsec tion (e) of this section shall be determined in accordance with section 78u-4(f) of this title.

(B) For purposes of this paragraph, the term "outside director" shall have the meaning given such term by rule or regulation of the Commission.

(g) Offering price to public as maximum amount recoverable

In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

UNITED STATES CODE ANNOTATED
TITLE 15. COMMERCE AND TRADE
CHAPTER 2A--SECURITIES AND TRUST INDENTURES
SUBCHAPTER I--DOMESTIC SECURITIES

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§ 77l. Civil liabilities arising in connection with prospectuses and communications

(a) In general

Any person who--

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraphs (2) and (14) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable, subject to subsection (b) of this section, to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon,

upon the tender of such security, or for damages if he no longer owns the security.

(b) Loss causation

In an action described in subsection (a)(2) of this section, if the person who offered or sold such security proves that any portion or all of the amount recoverable under subsection (a)(2) of this section represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement not misleading, then such portion or amount, as the case may be, shall not be recoverable.

UNITED STATES CODE ANNOTATED
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SUBCHAPTER I--DOMESTIC SECURITIES

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§ 77o. Liability of controlling persons

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

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Current through P.L. 108-30, approved 05-29-03

§ 77z-1. Private securities litigation

(a) Private class actions

(1) In general

The provisions of this subsection shall apply to each private action arising under this subchapter that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure.

(2) Certification filed with complaint

(A) In general

Each plaintiff seeking to serve as a representative party on behalf of a class shall provide a sworn certification, which shall be personally signed by such plaintiff and filed with the complaint, that--

(i) states that the plaintiff has reviewed the complaint and authorized its filing;

(ii) states that the plaintiff did not purchase the security that is the subject of the complaint at the direction of plaintiff's counsel or in order to participate in any private action arising under this subchapter;

(iii) states that the plaintiff is willing to serve as a representative party on behalf of a class, including providing testimony at deposition and trial, if necessary;

(iv) sets forth all of the transactions of the plaintiff in the security that is the subject of the complaint during the class period specified in the complaint;

(v) identifies any other action under this subchapter, filed during the 3-year period preceding the date on which the certification is signed by the plaintiff, in which the plaintiff has sought to serve, or served, as a representative party on behalf of a class; and

(vi) states that the plaintiff will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court in accordance with paragraph (4).

(B) Nonwaiver of attorney-client privilege

The certification filed pursuant to subparagraph (A) shall not be construed to be a waiver of the attorney-client privilege.

(3) Appointment of lead plaintiff

(A) Early notice to class members

(i) In general

Not later than 20 days after the date on which the complaint is filed, the plaintiff or plaintiffs shall cause to be published, in a widely circulated national business-oriented publication or wire service, a notice advising members of the purported plaintiff class--

(I) of the pendency of the action, the claims asserted therein, and the purported class period; and

(II) that, not later than 60 days after the date on which the notice is published, any member of the purported class may move the court to serve as lead plaintiff of the purported class.

(ii) Multiple actions

If more than one action on behalf of a class asserting substantially the same claim or claims arising under this subchapter is filed, only the plaintiff or plaintiffs in the first filed action shall be required to cause notice to be published in accordance with clause (i).

(iii) Additional notices may be required under Federal Rules

Notice required under clause (i) shall be in addition to any notice required pursuant to the Federal Rules of Civil Procedure.

(B) Appointment of lead plaintiff

(i) In general

Not later than 90 days after the date on which a notice is published under subparagraph (A)(i), the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the complaint or complaints, and shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members (hereafter in this paragraph referred to as the "most adequate plaintiff") in accordance with this subparagraph.

(ii) Consolidated actions

If more than one action on behalf of a class asserting substantially the same claim or claims arising under

this subchapter has been filed, and any party has sought to consolidate those actions for pretrial purposes or for trial, the court shall not make the determination required by clause (i) until after the decision on the motion to consolidate is rendered. As soon as practicable after such decision is rendered, the court shall appoint the most adequate plaintiff as lead plaintiff for the consolidated actions in accordance with this subparagraph.

(iii) Rebuttable presumption

(I) In general

Subject to subclause (II), for purposes of clause (i),the court shall adopt a presumption that themost adequate plaintiff in any private action arising under this subchapter is the person or group of persons that--

(aa) has either filed the complaint or made a motion in response to a notice under subparagraph (A)(i);

(bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

(II) Rebuttal evidence

The presumption described in subclause (I) may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff--

(aa) will not fairly and adequately protect the interests of the class; or

(bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class.

(iv) Discovery

For purposes of this subparagraph, discovery relating to whether a member or members of the purported plaintiff class is the most adequate plaintiff may be conducted by a plaintiff only if the plaintiff first demonstrates a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class.

(v) Selection of lead counsel

The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.

(vi) Restrictions on professional plaintiffs

Except as the court may otherwise permit, consistent with the purposes of this section, a person may be a lead plaintiff, or an officer, director, or fiduciary of a lead plaintiff, in no more than 5 securities class actions brought as plaintiff class actions pursuant to the Federal Rules of Civil Procedure during any 3-year period.

(4) Recovery by plaintiffs

The share of any final judgment or of any settlement that is awarded to a representative party serving on behalf of a class shall be equal, on a per share basis, to the portion of the final judgment or settlement awarded to all other members of the class. Nothing in this paragraph shall be construed to limit the award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party serving on behalf of the class.

(5) Restrictions on settlements under seal

The terms and provisions of any settlement agreement of a class action shall not be filed under seal, except that on motion of any party to the settlement, the court may order filing under seal for those portions of a settlement agreement as to which good cause is shown for such filing under seal. For purposes of this paragraph, good cause shall exist only if publication of a term or provision of a settlement agreement would cause direct and substantial harm to any party.

(6) Restrictions on payment of attorneys' fees and expenses

Total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class.

(7) Disclosure of settlement terms to class members

Any proposed or final settlement agreement that is published or otherwise disseminated to the class shall include each of the following statements, along with a cover page summarizing the information contained in such statements:

(A) Statement of plaintiff recovery

The amount of the settlement proposed to be distributed to the parties to the action, determined in the aggregate and on an average per share basis.

(B) Statement of potential outcome of case

(i) Agreement on amount of damages

If the settling parties agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this

subchapter, a statement concerning the average amount of such potential damages per share.

(ii) Disagreement on amount of damages

If the parties do not agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this subchapter, a statement from each settling party concerning the issue or issues on which the parties disagree.

(iii) Inadmissibility for certain purposes

A statement made in accordance with clause (i) or (ii) concerning the amount of damages shall not be admissible in any Federal or State judicial action or administrative proceeding, other than an action or proceeding arising out of such statement.

(C) Statement of attorneys' fees or costs sought

If any of the settling parties or their counsel intend to apply to the court for an award of attorneys' fees or costs from any fund established as part of the settlement, a statement indicating which parties or counsel intend to make such an application, the amount of fees and costs that will be sought (including the amount of such fees and costs determined on an average per share basis), and a brief explanation supporting the fees and costs sought.

(D) Identification of lawyers' representatives

The name, telephone number, and address of one or more representatives of counsel for the plaintiff class who will be reasonably available to answer questions from class members concerning any matter contained in any notice of settlement published or otherwise disseminated to the class.

(E) Reasons for settlement

A brief statement explaining the reasons why the parties are proposing the settlement.

(F) Other information

Such other information as may be required by the court.

(8) Attorney conflict of interest

If a plaintiff class is represented by an attorney who directly owns or otherwise has a beneficial interest in the securities that are the subject of the litigation, the court shall make a determination of whether such ownership or other interest constitutes a conflict of interest sufficient to disqualify the attorney from representing the plaintiff class.

(b) Stay of discovery; preservation of evidence

(1) In general

In any private action arising under this subchapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds, upon the motion of any party, that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.

(2) Preservation of evidence

During the pendency of any stay of discovery pursuant to this subsection, unless otherwise ordered by the court, any party to the action with actual notice of the allegations contained in the complaint shall treat all documents, data compilations (including electronically recorded or stored data), and tangible objects that are in the custody or control of such person and that are

relevant to the allegations, as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure.

(3) Sanction for willful violation

A party aggrieved by the willful failure of an opposing party to comply with paragraph (2) may apply to the court for an order awarding appropriate sanctions.

(4) Circumvention of stay of discovery

Upon a proper showing, a court may stay discovery proceedings in any private action in a State court as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this subsection.

(c) Sanctions for abusive litigation

(1) Mandatory review by court

In any private action arising under this subchapter, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

(2) Mandatory sanctions

If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or

attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

(3) Presumption in favor of attorneys' fees and costs

(A) In general

Subject to subparagraphs (B) and (C), for purposes of paragraph (2), the court shall adopt a presumption that the appropriate sanction--

(i) for failure of any responsive pleading or dispositive motion to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation; and

(ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

(B) Rebuttal evidence

The presumption described in subparagraph (A) may be rebutted only upon proof by the party or attorney against whom sanctions are to be imposed that--

(i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or

(ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was de minimis.

(C) Sanctions

If the party or attorney against whom sanctions are to be imposed meets its burden under subparagraph (B), the court shall award the sanctions that the court deems appropriate pursuant to Rule 11 of the Federal Rules of Civil Procedure.

(d) Defendant's right to written interrogatories

In any private action arising under this subchapter in which the plaintiff may recover money damages only on proof that a defendant acted with a particular state of mind, the court shall, when requested by a defendant, submit to the jury a written interrogatory on the issue of each such defendant's state of mind at the time the alleged violation occurred.

UNITED STATES CODE ANNOTATED
TITLE 15. COMMERCE AND TRADE
CHAPTER 2B--SECURITIES EXCHANGES

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Current through P.L. 108-30, approved 05-29-03

§ 78u-4. Private securities litigation

(a) Private class actions

(1) In general

The provisions of this subsection shall apply in each private action arising under this chapter that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure.

(2) Certification filed with complaint

(A) In general

Each plaintiff seeking to serve as a representative party on behalf of a class shall provide a sworn certification, which shall be personally signed by such plaintiff and filed with the complaint, that--

(i) states that the plaintiff has reviewed the complaint and authorized its filing;

(ii) states that the plaintiff did not purchase the security that is the subject of the complaint at the direction of plaintiffs counsel or in order to participate in any private action arising under this chapter;

(iii) states that the plaintiff is willing to serve as a representative party on behalf of a class, including providing testimony at deposition and trial, if necessary;

(iv) sets forth all of the transactions of the plaintiff in the security that is the subject of the complaint during the class period specified in the complaint;

(v) identifies any other action under this chapter, filed during the 3-year period preceding the date on which the certification is signed by the plaintiff, in which the plaintiff has sought to serve as a representative party on behalf of a class; and

(vi) states that the plaintiff will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court in accordance with paragraph (4).

(B) Nonwaiver of attorney-client privilege

The certification filed pursuant to subparagraph (A) shall not be construed to be a waiver of the attorney-client privilege.

(3) Appointment of lead plaintiff

(A) Early notice to class members

(i) In general

Not later than 20 days after the date on which the complaint is filed, the plaintiff or plaintiffs shall cause to be published, in a widely circulated national business-oriented publication or wire service, a notice advising members of the purported plaintiff class—

(I) of the pendency of the action, the claims asserted therein, and the purported class period; and

(II) that, not later than 60 days after the date on which the notice is published, any member of the

purported class may move the court to serve as lead plaintiff of the purported class.

(ii) Multiple actions

If more than one action on behalf of a class asserting substantially the same claim or claims arising under this chapter is filed, only the plaintiff or plaintiffs in the first filed action shall be required to cause notice to be published in accordance with clause (i).

(iii) Additional notices may be required under Federal rules

Notice required under clause (i) shall be in addition to any notice required pursuant to the Federal Rules of Civil Procedure.

(B) Appointment of lead plaintiff

(i) In general

Not later than 90 days after the date on which a notice is published under subparagraph (A)(i), the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the complaint or complaints, and shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members (hereafter in this paragraph referred to as the "most adequate plaintiff") in accordance with this subparagraph.

(ii) Consolidated actions

If more than one action on behalf of a class asserting substantially the same claim or claims arising under this chapter has been filed, and any party has sought to consolidate those actions for pretrial purposes or

for trial, the court shall not make the determination required by clause (i) until after the decision on the motion to consolidate is rendered. As soon as practicable after such decision is rendered, the court shall appoint the most adequate plaintiff as lead plaintiff for the consolidated actions in accordance with this paragraph.

(iii) Rebuttable presumption

(I) In general

Subject to subclause (II), for purposes of clause (i), the court shall adopt a presumption that the most adequate plaintiff in any private action arising under this chapter is the person or group of persons that—

(aa) has either filed the complaint or made a motion in response to a notice under subparagraph (A)(i);

(bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

(II) Rebuttal evidence

The presumption described in subclause (I) may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff—

(aa) will not fairly and adequately protect the interests of the class; or

(bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class.

(iv) Discovery

For purposes of this subparagraph, discovery relating to whether a member or members of the purported plaintiff class is the most adequate plaintiff may be conducted by a plaintiff only if the plaintiff first demonstrates a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class.

(v) Selection of lead counsel

The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.

(vi) Restrictions on professional plaintiffs

Except as the court may otherwise permit, consistent with the purposes of this section, a person may be a lead plaintiff, or an officer, director, or fiduciary of a lead plaintiff, in no more than 5 securities class actions brought as plaintiff class actions pursuant to the Federal Rules of Civil Procedure during any 3-year period.

(4) Recovery by plaintiffs

The share of any final judgment or of any settlement that is awarded to a representative party serving on behalf of a class shall be equal, on a per share basis, to the portion of the final judgment or settlement awarded to all other members of the class. Nothing in this paragraph shall be construed to limit the award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party serving on behalf of a class.

(5) Restrictions on settlements under seal

The terms and provisions of any settlement agreement of a class action shall not be filed under seal, except that on motion of any party to the settlement, the court may order filing under seal for those portions of a settlement agreement as to which good cause is shown for such filing under seal. For purposes of this paragraph, good cause shall exist only if publication of a term or provision of a settlement agreement would cause direct and substantial harm to any party.

(6) Restrictions on payment of attorneys' fees and expenses

Total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class.

(7) Disclosure of settlement terms to class members

Any proposed or final settlement agreement that is published or otherwise disseminated to the class shall include each of the following statements, along with a cover page summarizing the information contained in such statements:

(A) Statement of plaintiff recovery

The amount of the settlement proposed to be distributed to the parties to the action, determined in the aggregate and on an average per share basis.

(B) Statement of potential outcome of case

(i) Agreement on amount of damages

If the settling parties agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this chapter, a statement concerning the average amount of such potential damages per share.

(ii) Disagreement on amount of damages

If the parties do not agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this chapter, a statement from each settling party concerning the issue or issues on which the parties disagree.

(iii) Inadmissibility for certain purposes

A statement made in accordance with clause (i) or (ii) concerning the amount of damages shall not be admissible in any Federal or State judicial action or administrative proceeding, other than an action or proceeding arising out of such statement.

(C) Statement of attorneys' fees or costs sought

If any of the settling parties or their counsel intend to apply to the court for an award of attorneys' fees or costs from any fund established as part of the settlement, a statement indicating which parties or counsel intend to make such an application, the amount of fees and costs that will be sought (including the amount of such fees and costs determined on an average per share basis), and a brief explanation supporting the fees and costs sought. Such information shall be clearly summarized on the cover page of any notice to a party of any proposed or final settlement agreement.

(D) Identification of lawyers' representatives

The name, telephone number, and address of one or more representatives of counsel for the plaintiff class who will be reasonably available to answer questions from class members concerning any matter contained in any notice of settlement published or otherwise disseminated to the class.

(E) Reasons for settlement

A brief statement explaining the reasons why the parties are proposing the settlement.

(F) Other information

Such other information as may be required by the court.

(8) Security for payment of costs in class actions

In any private action arising under this chapter that is certified as a class action pursuant to the Federal Rules of Civil Procedure, the court may require an undertaking from the attorneys for the plaintiff class, the plaintiff class, or both, or from the attorneys for the defendant, the defendant, or both, in such proportions and at such times as the court determines are just and equitable, for the payment of fees and expenses that may be awarded under this subsection.

(9) Attorney conflict of interest

If a plaintiff class is represented by an attorney who directly owns or otherwise has a beneficial interest in the securities that are the subject of the litigation, the court shall make a determination of whether such ownership or other interest constitutes a conflict of interest sufficient to disqualify the attorney from representing the plaintiff class.

(b) Requirements for securities fraud actions

(1) Misleading statements and omissions

In any private action arising under this chapter in which the plaintiff alleges that the defendant—

(A) made an untrue statement of a material fact; or

(B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;

the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

(2) Required state of mind

In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

(3) Motion to dismiss; stay of discovery

(A) Dismissal for failure to meet pleading requirements

In any private action arising under this chapter, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met.

(B) Stay of discovery

In any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.

(C) Preservation of evidence

(i) In general

During the pendency of any stay of discovery pursuant to this paragraph, unless otherwise ordered by the court, any party to the action with actual notice of the allegations contained in the complaint shall treat all documents, data compilations (including electronically recorded or stored data), and tangible objects that are in the custody or control of such person and that are relevant to the allegations, as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure.

(ii) Sanction for willful violation

A party aggrieved by the willful failure of an opposing party to comply with clause (i) may apply to the court for an order awarding appropriate sanctions.

(D) Circumvention of stay of discovery

Upon a proper showing, a court may stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this paragraph.

(4) Loss causation

In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.

(c) Sanctions for abusive litigation

(1) Mandatory review by court

In any private action arising under this chapter, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

(2) Mandatory sanctions

If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

(3) Presumption in favor of attorneys' fees and costs

(A) In general

Subject to subparagraphs (B) and (C), for purposes of paragraph (2), the court shall adopt a presumption that the appropriate sanction—

(i) for failure of any responsive pleading or dispositive motion to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation; and

(ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

(B) Rebuttal evidence

The presumption described in subparagraph (A) may be rebutted only upon proof by the party or attorney against whom sanctions are to be imposed that—

(i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or

(ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was de minimis.

(C) Sanctions

If the party or attorney against whom sanctions are to be imposed meets its burden under subparagraph (B), the court shall award the sanctions that the court deems appropriate pursuant to Rule 11 of the Federal Rules of Civil Procedure.

(d) Defendant's right to written interrogatories

In any private action arising under this chapter in which the plaintiff may recover money damages, the court shall, when requested by a defendant, submit to the jury a written interrogatory on the issue of each such defendant's state of mind at the time the alleged violation occurred.

(e) Limitation on damages

(1) In general

Except as provided in paragraph (2), in any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

(2) Exception

In any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, if the plaintiff sells or repurchases the subject security prior to the expiration of the 90-day period described in paragraph (1), the plaintiff's damages shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the security and the mean trading price of the security during the period beginning immediately after dissemination of information correcting the misstatement or omission and ending on the date on which the plaintiff sells or repurchases the security.

(3) Definition

For purposes of this subsection, the "mean trading price" of a security shall be an average of the daily trading price of that security, determined as of the close of the market each day during the 90-day period referred to in paragraph (1).

(f) Proportionate liability

(1) Applicability

Nothing in this subsection shall be construed to create, affect, or in any manner modify, the standard for liability associated with any action arising under the securities laws.

(2) Liability for damages

(A) Joint and several liability

Any covered person against whom a final judgment is entered in a private action shall be liable for damages jointly and severally only if the trier of fact specifically determines that such covered person knowingly committed a violation of the securities laws.

(B) Proportionate liability

(i) In general

Except as provided in subparagraph (A), a covered person against whom a final judgment is entered in a private action shall be liable solely for the portion of the judgment that corresponds to the percentage of responsibility of that covered person, as determined under paragraph (3).

(ii) Recovery by and costs of covered person

In any case in which a contractual relationship permits, a covered person that prevails in any private action may recover the attorney's fees and costs of that covered person in connection with the action.

(3) Determination of responsibility

(A) In general

In any private action, the court shall instruct the jury to answer special interrogatories, or if there is no jury,

shall make findings, with respect to each covered person and each of the other persons claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff, including persons who have entered into settlements with the plaintiff or plaintiffs, concerning—

(i) whether such person violated the securities laws;

(ii) the percentage of responsibility of such person, measured as a percentage of the total fault of all persons who caused or contributed to the loss incurred by the plaintiff; and

(iii) whether such person knowingly committed a violation of the securities laws.

(B) Contents of special interrogatories or findings

The responses to interrogatories, or findings, as appropriate, under subparagraph (A) shall specify the total amount of damages that the plaintiff is entitled to recover and the percentage of responsibility of each covered person found to have caused or contributed to the loss incurred by the plaintiff or plaintiffs.

(C) Factors for consideration

In determining the percentage of responsibility under this paragraph, the trier of fact shall consider—

(i) the nature of the conduct of each covered person found to have caused or contributed to the loss incurred by the plaintiff or plaintiffs; and

(ii) the nature and extent of the causal relationship between the conduct of each such person and the damages incurred by the plaintiff or plaintiffs.

(4) Uncollectible share

(A) In general

Notwithstanding paragraph (2)(B), upon motion made not later than 6 months after a final judgment is entered in any private action, the court determines that all or part of the share of the judgment of the covered person is not collectible against that covered person, and is also not collectible against a covered person described in paragraph (2)(A), each covered person described in paragraph (2)(B) shall be liable for the uncollectible share as follows:

(i) Percentage of net worth

Each covered person shall be jointly and severally liable for the uncollectible share if the plaintiff establishes that—

(I) the plaintiff is an individual whose recoverable damages under the final judgment are equal to more than 10 percent of the net worth of the plaintiff; and

(II) the net worth of the plaintiff is equal to less than $200,000.

(ii) Other plaintiffs

With respect to any plaintiff not described in subclauses (I) and (II) of clause (i), each covered person shall be liable for the uncollectible share in proportion to the percentage of responsibility of that covered person, except that the total liability of a covered person under this clause may not exceed 50 percent of the proportionate share of that covered person, as determined under paragraph (3)(B).

(iii) Net worth

For purposes of this subparagraph, net worth shall be determined as of the date immediately preceding the date of the purchase or sale (as applicable) by the plaintiff of the security that is the subject of the

action, and shall be equal to the fair market value of assets, minus liabilities, including the net value of the investments of the plaintiff in real and personal property (including personal residences).

(B) Overall limit

In no case shall the total payments required pursuant to subparagraph (A) exceed the amount of the uncollectible share.

(C) Covered persons subject to contribution

A covered person against whom judgment is not collectible shall be subject to contribution and to any continuing liability to the plaintiff on the judgment.

(5) Right of contribution

To the extent that a covered person is required to make an additional payment pursuant to paragraph (4), that covered person may recover contribution—

(A) from the covered person originally liable to make the payment;

(B) from any covered person liable jointly and severally pursuant to paragraph (2)(A);

(C) from any covered person held proportionately liable pursuant to this paragraph who is liable to make the same payment and has paid less than his or her proportionate share of that payment; or

(D) from any other person responsible for the conduct giving rise to the payment that would have been liable to make the same payment.

(6) Nondisclosure to jury

The standard for allocation of damages under paragraphs (2) and (3) and the procedure for reallocation of uncollectible shares under paragraph (4) shall not be disclosed to members of the jury.

(7) Settlement discharge

(A) In general

A covered person who settles any private action at any time before final verdict or judgment shall be discharged from all claims for contribution brought by other persons. Upon entry of the settlement by the court, the court shall enter a bar order constituting the final discharge of all obligations to the plaintiff of the settling covered person arising out of the action. The order shall bar all future claims for contribution arising out of the action—

(i) by any person against the settling covered person; and

(ii) by the settling covered person against any person, other than a person whose liability has been extinguished by the settlement of the settling covered person.

(B) Reduction

If a covered person enters into a settlement with the plaintiff prior to final verdict or judgment, the verdict or judgment shall be reduced by the greater of—

(i) an amount that corresponds to the percentage of responsibility of that covered person; or

(ii) the amount paid to the plaintiff by that covered person.

(8) Contribution

A covered person who becomes jointly and severally liable for damages in any private action may recover contribution from any other person who, if joined in the original action, would have been liable for the same damages. A claim for contribution shall be determined based on the percentage of responsibility of the claimant

and of each person against whom a claim for contribution is made.

(9) Statute of limitations for contribution

In any private action determining liability, an action for contribution shall be brought not later than 6 months after the entry of a final, nonappealable judgment in the action, except that an action for contribution brought by a covered person who was required to make an additional payment pursuant to paragraph (4) may be brought not later than 6 months after the date on which such payment was made.

(10) Definitions

For purposes of this subsection—

(A) a covered person "knowingly commits a violation of the securities laws"—

(i) with respect to an action that is based on an untrue statement of material fact or omission of a material fact necessary to make the statement not misleading, if—

(I) that covered person makes an untrue statement of a material fact, with actual knowledge that the representation is false, or omits to state a fact necessary in order to make the statement made not misleading, with actual knowledge that, as a result of the omission, one of the material representations of the covered person is false; and

(II) persons are likely to reasonably rely on that misrepresentation or omission; and

(ii) with respect to an action that is based on any conduct that is not described in clause (i), if that covered person engages in that conduct with actual

knowledge of the facts and circumstances that make the conduct of that covered person a violation of the securities laws;

(B) reckless conduct by a covered person shall not be construed to constitute a knowing commission of a violation of the securities laws by that covered person;

(C) the term "covered person" means–

(i) a defendant in any private action arising under this chapter; or

(ii) a defendant in any private action arising under section 77k of this title, who is an outside director of the issuer of the securities that are the subject of the action; and

(D) the term "outside director" shall have the meaning given such term by rule or regulation of the Commission.

(g) Redesignated (f)

UNITED STATES CODE ANNOTATED
FEDERAL RULES OF CIVIL PROCEDURE FOR THE
UNITED STATES DISTRICT COURTS
III. PLEADINGS AND MOTIONS

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Amendments received to 05-23-03

Rule 8. General Rules of Pleading

(a) Claims for Relief. A pleading which sets forth a claim for relief, whether an original claim, counterclaim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief the pleader seeks. Relief in the alternative or of several different types may be demanded.

UNITED STATES CODE ANNOTATED
FEDERAL RULES OF CIVIL PROCEDURE FOR THE UNITED STATES DISTRICT COURTS
III. PLEADINGS AND MOTIONS

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Rule 9. Pleading Special Matters

(b) Fraud, Mistake, Condition of the Mind. In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

UNITED STATES CODE ANNOTATED
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III. PLEADINGS AND MOTIONS

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Amendments received to 05-23-03

Rule 11. Signing of Pleadings, Motions, and Other Papers; Representations to Court; Sanctions

(a) Signature. Every pleading, written motion, and other paper shall be signed by at least one attorney of record in the attorney's individual name, or, if the party is not represented by an attorney, shall be signed by the party. Each paper shall state the signer's address and telephone number, if any. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party.

(b) Representations to Court. By presenting to the court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,--

(1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

(2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(3) the allegations and other factual contentions have

evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

(c) Sanctions. If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.

(1) How Initiated.

(A) By Motion. A motion for sanctions under this rule shall be made separately from other motions or requests and shall describe the specific conduct alleged to violate subdivision (b). It shall be served as provided in Rule 5, but shall not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected. If warranted, the court may award to the party prevailing on the motion the reasonable expenses and attorney's fees incurred in presenting or opposing the motion. Absent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees.

(B) On Court's Initiative. On its own initiative, the court may enter an order describing the specific conduct that appears to violate subdivision (b) and directing an attorney, law firm, or party to show cause why it has not violated subdivision (b) with respect thereto.

(2) Nature of Sanction; Limitations. A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated. Subject to the limitations in subparagraphs (A) and (B), the sanction may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into court, or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation.

(A) Monetary sanctions may not be awarded against a represented party for a violation of subdivision (b)(2).

(B) Monetary sanctions may not be awarded on the court's initiative unless the court issues its order to show cause before a voluntary dismissal or settlement of the claims made by or against the party which is, or whose attorneys are, to be sanctioned.

(3) Order. When imposing sanctions, the court shall describe the conduct determined to constitute a violation of this rule and explain the basis for the sanction imposed.

(d) Inapplicability to Discovery. Subdivisions (a) through (c) of this rule do not apply to disclosures and discovery requests, responses, objections, and motions that are subject to the provisions of Rules 26 through 37.

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(2)

No. 03-2

In The
Supreme Court of the United States

OXFORD ASSET MANAGEMENT, LTD.,
and SUSMAN & WATKINS,

Petitioners,

v.

MICHAEL JAHARIS, *et al.*,

Respondents.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Eleventh Circuit

KOS RESPONDENTS' BRIEF IN OPPOSITION

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23 pp

QUESTIONS PRESENTED

1. Whether a complaint that is based on internally inconsistent factual allegations, unwarranted deductions, and legal conclusions satisfies the pleading standard of Fed. R. Civ. P. 8(a), which requires a "plain statement of the claim showing that the pleader is entitled to relief"?

2. Whether liability for an omission can arise under § 11 and § 12(a)(2) of the Securities Act of 1933 if the prospectus at issue (a) has disclosed everything specifically required by the securities laws, and (b) was not misleading without the omitted information?

3. Whether a district court may impose sanctions under the Private Securities Litigation Reform Act and Fed. R. Civ. P. 11 on the ground that the evidence uncovered by the Plaintiffs' investigation established that their claims were "objectively frivolous"?

LIST OF PARTIES

The Petition correctly lists the parties; however, for convenience, this brief uses "the Kos Respondents" to designate collectively Kos Pharmaceuticals, Inc. and the related individual defendants, Michael Jaharis, Daniel M. Bell, Duncan H. Cocroft, Juan F. Rodriguez, Robert E. Baldini, John Brademas, Steve Jaharis, Louis Lasagna, Mark Novitch, and Frederick B. Whittemore.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Respondent Kos Pharmaceuticals, Inc. states that it has no parent corporation and that no publicly held company owns 10% or more of its stock.

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COUNTERSTATEMENT OF THE CASE

Petitioners Oxford Asset Management, Ltd. and Susman & Watkins (collectively "Oxford") misstate the holdings of the courts below in an effort to create an issue worthy of review. An analysis of the actual rulings in this case demonstrates that the petition lacks merit and should be denied.

The Eleventh Circuit's decision in this case does not raise the first question posed by Oxford – whether a heightened pleading standard applies to a complaint seeking recovery under § 11 and § 12(a)(2) of the Securities Act of 1933. The Eleventh Circuit did not even mention, much less rule on a heightened pleading standard. Rather, it merely affirmed the district court's express holding that the usual notice pleading standard of Fed. R. Civ. P. 8(a) applies to Oxford's strict liability securities claims. *See* Appendix to Petition (hereinafter "App.") 7, 34-37.

Oxford's description of the lower courts' "duty to disclose" rulings also is flawed. Oxford inaccurately states that the district court held that "Kos's omission of its first eight weeks of prescription data was immaterial as a matter of law." Petition at 6. The district court pointed out that the prospectus could not have included eight weeks of prescription data because the offering closed before the eighth week. App. 52. It held that the earlier, very preliminary data was not material because, according to the Uhl report on which Oxford based its complaint, it is the eighth week that is the indicator of future commercial performance. App. 9.

Contrary to Oxford's suggestion, the Eleventh Circuit did not "find" that the first eight weeks of prescription data was material. *See* Petition at 17. Like the district

court, the Eleventh Circuit found that "Oxford's assertion that Kos possessed seven weeks of data is literally unbelievable," and that "Kos probably did not possess even six weeks of information." App. 10. The Eleventh Circuit merely "assumed" that the first six weeks of data were material for purposes of a motion to dismiss. App. 11.

After observing that the prospectus contained specific cautionary statements regarding Niaspan®'s market acceptance, the Eleventh Circuit held that there was no duty to disclose the preliminary prescription data because this information was not required by the securities laws and the prospectus was not misleading without it. App. 12-16. The Eleventh Circuit's opinion, therefore, tracks the precise language of § 11, which imposes omission liability only if the prospectus "omitted to state a material fact required to be stated therein or [if the omitted information was] necessary to make the statements therein not misleading." App. 79.

The Eleventh Circuit did not levy sanctions as suggested by Oxford. *See* Petition at 3. It affirmed the award as a proper exercise of discretion because Oxford's claims "were objectively frivolous and counsel for Plaintiffs should have been aware when signing off on the Complaint that it was factually deficient." App. 68. After sifting through Plaintiffs' unsubstantiated and inconsistent allegations, the district court concluded: "In short based on the evidence uncovered by their investigation, Plaintiffs should not have commenced this action." App. 67.

REASONS FOR DENYING THE PETITION

None of the questions posed by Oxford warrants review in this case because each is premised on a less than candid description of the rulings below. This is not an appropriate case for deciding the first question, whether a heightened pleading standard should apply to claims seeking strict liability recovery under § 11 and § 12(a)(2) of the Securities Act of 1933, because the Eleventh Circuit affirmed the dismissal based on the district court's express and proper application of the more lenient notice pleading standard of Fed. R. Civ. P. 8(a). There is no need for the Court to review the second question, the scope of the duty to disclose material information in a prospectus, because the well reasoned decision of the Eleventh Circuit tracks the language of the Securities Act and is entirely consistent with the law of the Second Circuit and other federal courts. The sanctions issue raised by the third question addresses only a fact-intensive discretionary ruling which, as Rule 10 of this Court advises, is not appropriate for review by writ of certiorari.

I. BECAUSE THE COURT BELOW PROPERLY STATED AND APPLIED THE NOTICE PLEADING STANDARD OF FED. R. CIV. P. 8(a), THIS IS NOT AN APPROPRIATE CASE FOR DECIDING WHETHER STRICT LIABILITY SECURITIES CLAIMS ARE SUBJECT TO A HEIGHTENED PLEADING STANDARD

This is not an appropriate case for deciding whether strict liability securities claims are subject to a heightened pleading standard because: (1) the Eleventh Circuit did not hold that a heightened pleading standard applies to Oxford's § 11 and § 12(a)(2) claims; (2) the Eleventh

Circuit correctly affirmed the dismissal of the claims under the notice pleading standard of Fed. R. Civ. P. 8(a); and (3) even assuming an error in the application of the Rule 8 standard, such error would not merit review by the Supreme Court.

1. Neither the Eleventh Circuit nor the district court held that a heightened pleading standard applies to claims under § 11 and § 12(a)(2) of the Securities Act of 1933. Regarding Oxford's "strict liability" securities claims, the district court observed that "[u]nder Fed. R. Civ. P. 8(a)(2), Plaintiffs are required only to set forth in the complaint 'a short and plain statement of the claim showing that the pleader is entitled to relief.'" App. 35. The court also noted, however, that a complaint does not comply with Rule 8 if it is based on internally inconsistent factual claims, unwarranted deductions, or mere legal conclusions. App. 35-36. It reasoned that such a complaint fails because inconsistent or conclusory factual allegations do not "give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests." *See* App. 35. The district court further explained:

> [T]he demands on the pleader are minimal. Nevertheless, minimal requirements are not tantamount to nonexistent requirements. To survive a motion to dismiss, plaintiffs must set forth factual allegations, either direct or inferential, respecting each material element necessary to sustain recovery under some actionable legal theory.

App. 36 (quoting *Cooperman v. Individual Inc.*, 171 F.3d 43, 47-48 (1st Cir. 1999)).

Later in the opinion, the district court applied a much different pleading standard to Oxford's securities fraud claim. "Plaintiffs' claim of fraud under Rule 10b-5 must also satisfy the requirements of Federal Rule of Civil Procedure 9(b), which requires that the 'circumstances constituting fraud . . . must be stated with particularity.'" App. 55. The district court limited the discussion of this heightened pleading standard to its analysis of the Rule 10b-5 claim. In fact, the district court expressly rejected the argument that the § 11 and § 12(a)(2) claims were subject to the heightened pleading requirements of Fed. R. Civ. P. 9 and the Private Securities Litigation Reform Act. App. 41 n.19 ("We do not find it would be appropriate to apply Rule 9(b) to the case before us.").

Oxford appealed the dismissal of its § 11 and § 12(a)(2) claims, but not the fraud claims brought under Rule 10b-5. App. 6. In affirming, the Eleventh Circuit did not suggest that the pleading standard for Rule 10b-5 claims should govern the § 11 and § 12(a) claims. It just accepted the district court's observation that when the complaint is reviewed under Fed. R. Civ. P. 8(a): "The plaintiff's factual allegations are accepted as true. . . . Dismissal is not appropriate unless it is plain that the plaintiff can prove no set of facts that would support the claims in the complaint. . . . However, conclusory allegations, unwarranted deductions of facts or legal conclusions masquerading as facts will not prevent dismissal." App. 7.

This common sense principle is not novel; nor does it conflict with the pleading standards embraced by the Fifth, Eighth, or any other circuit as Oxford suggests. In fact, the Eleventh Circuit lifted its "Standard of Review" almost verbatim from a Fifth Circuit case, which cited a leading treatise for this unremarkable proposition. *Id.*

(citing *Fernandez-Montes v. Allied Pilots Ass'n*, 987 F.2d 278, 284 (5th Cir. 1993) (citing 2A MOORE'S FEDERAL PRACTICE ¶ 12.07[2.-5], at 12-64 n.6 (2d ed. 1991) (collecting cases)).

Thus, even in the Fifth and other circuits, a non-fraud claim cannot survive a motion to dismiss under notice pleading standards if it is based on unwarranted deductions or mere legal conclusions. *Fernandez-Montes*, 987 F.2d at 284; *see also Scheid v. Fanny Farmer Candy Shops, Inc.*, 859 F.2d 434 (6th Cir. 1988) (noting that legal conclusions do not satisfy notice pleading requirement). Because there is no conflict among the circuits on the only pleading standard discussed by the Eleventh Circuit, this is not an appropriate case for resolving the first question presented by Oxford's petition.

2. Review of the pleading standard is not warranted by Oxford's unsupportable assertion that the Eleventh Circuit implicitly applied an unexplained "heightened fact pleading standard" to the § 11 and § 12(a) claims. Consistent with the stated standard of review, the Eleventh Circuit affirmed the dismissal because these claims were based on internally inconsistent facts and unwarranted deductions.

The "efficacy" claim is illustrative. Citing two studies showing that Niaspan® increases HDL, the "good cholesterol," by 23% and 26%, Oxford alleged that the prospectus falsely represented that Niaspan® increases HDL by a range of 22% to 32%. Noting that the studies identified by Oxford are consistent with the range described in the prospectus, the Eleventh Circuit held that this part of the complaint rested on unwarranted deductions. App. 17. In other words, the complaint failed to state a claim because

its allegations validated the representations made in the prospectus. "[W]hile notice pleading does not demand that a complaint expound the facts, a plaintiff who does so is bound by such exposition." *Romine v. Acxiom Corp.*, 296 F.3d 701, 706 (8th Cir. 2001) (citing *Bender v. Suburban Hospital, Inc.*, 159 F.3d 186, 192 (4th Cir. 1998)); *accord Jefferson v. Ambroz*, 90 F.3d 1291, 1296 (7th Cir. 1996). *See also Oxford Asset Management, Ltd.*, App. 8 (observing that on a motion to dismiss a securities case, the court may consider the prospectus and other documents identified in the complaint).

The Eleventh Circuit properly rejected other parts of the complaint for the same reason. For example, Oxford alleged that the prospectus failed to disclose that 88% of patients taking Niaspan® would experience flushing. The flushing allegations, however, failed to state a claim because the prospectus disclosed that "most patients taking Niaspan will sometimes flush," and that "[t]here can be no assurance . . . that patients using Niaspan will not suffer episodes of flushing that they consider intolerable." App. 18.

Regarding the sales representations, Oxford alleged that the prospectus was misleading because it failed to clarify that sales to wholesalers, not physicians, resulted in the $1.5 million in revenue reported for the quarter ending September 30, 1997. The courts below held that this part of the complaint failed to state a claim because the prospectus plainly stated that Kos was selling Niaspan® to wholesalers, and that Kos's sales force was giving away starter packs to physicians as a promotional effort. App. 20. The sales claim was conclusory and internally inconsistent because it was contradicted by disclosures in the prospectus, which were incorporated by reference into

the complaint. In sum, the Eleventh Circuit correctly applied the notice pleading standard when it affirmed the dismissal of this and the rest of Oxford's claims.

3. There is nothing to suggest that the Eleventh Circuit misapplied the correctly stated requirements of notice pleading. Even if there were, however, such an error would not merit review by the Supreme Court. "A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings or the misapplication of a properly stated rule of law." SUP. CT. R. 10.

II. THE ELEVENTH CIRCUIT'S "DUTY TO DISCLOSE" RULING IS CONSISTENT WITH THE PLAIN LANGUAGE OF THE CONTROLLING STATUTE AND THE LAW OF THE SECOND CIRCUIT

The Eleventh Circuit's ruling adheres to the plain language of § 11 as well as the overriding goals of the securities laws by using an objective, two-part inquiry for determining whether there is a duty to disclose arguably material information: (1) Is the information of a type specifically required by the securities laws?; and (2) If not, is the prospectus misleading without it? If, as in this case, the answer to both questions is no, the failure to disclose the information should not result in liability under § 11 or § 12(a)(2) of the Securities Act of 1933.

Ignoring the unambiguous language of the statute, Oxford argues that no such duty to disclose inquiry is necessary. According to Oxford, Second Circuit case law supports its position that the liability inquiry for § 11 and § 12(a)(2) claims begins and ends with a finding that the omitted information was material. Consequently, Oxford

contends that the Eleventh Circuit's opinion was wrong because it refused to find any § 11 or § 12(a) liability despite its assumption that the omitted information was material. Contrary to Oxford's contentions, however, the Eleventh Circuit's opinion not only is correct, it conforms to the language of the controlling statute and is consistent with the decisions of the Second Circuit and other federal courts.

1. The "duty to disclose" ruling in this case did nothing more than track the language of § 11, which imposes omission liability only when a prospectus has "omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." App. 79. The Eleventh Circuit reasoned that "[t]o hold that section 11(a) imposes liability unless the prospectus includes *all* material facts is simply to wholly ignore and render superfluous that section's qualifying language 'required to be stated therein or necessary to make the statements therein not misleading.'" App. 11 (emphasis in original). This rationale also applies to § 12(a), under which an omission is actionable only if the material fact would be necessary "to make the statements, in the light of the circumstances under which they were made, not misleading." App. 85.

Accordingly, the Eleventh Circuit correctly held that Oxford had failed to state an actionable omission under § 11 because, regardless of whether an investor might like to have very preliminary prescription data, the securities laws do not specifically require disclosure of this type of information and, considering the prospectus' many cautionary statements, the prospectus was not misleading without these figures. App. 11-16. The Eleventh Circuit noted that the prospectus disclosed several obstacles to

market acceptance of Niaspan®, including a specific warning that Niaspan®'s sales may grow slowly during the first three to six months of its marketing. App. 9-10.

The First Circuit similarly has relied on the plain language of § 11 to hold that "an issuer of securities owes no absolute duty to disclose all material information." *Cooperman v. Individual Inc.*, 171 F.3d 43, 49 (1st Cir. 1999). " 'Section 11 by its terms provides for the imposition of liability if a registration statement, as of its effective date: (1) 'contained an untrue statement of material fact'; (2) 'omitted to state a material fact required to be stated therein'; or (3) omitted to state a material fact 'necessary to make the statements therein not misleading.' " *Id.* at 50 (quoting *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194, 1204 (1st Cir. 1996)).

The Third Circuit is likewise in agreement that materiality alone will not create a duty to disclose information not otherwise required by the securities laws. "In addition to the duty to disclose specific information required by law, sections 11(a) and 12(2), and Rule 10b-5 impose upon defendants the duty to disclose any material facts that are necessary to make disclosed material statements, whether mandatory or volunteered, not misleading." *In re Craftmatic Sec. Litig.*, 890 F.2d 628, 641 (3d Cir. 1990). Thus, "when defendants voluntarily disclose information, they have a duty to disclose additional material facts only to the extent that the volunteered disclosure was misleading as to a material fact." *Id.* at n.17.

The Eleventh Circuit's "duty to disclose" ruling not only conforms to the language of the statute, it has a practical advantage. It provides issuers with an objective standard for determining whether information should be

included in a prospectus. Because materiality often is subject to dispute, an issuer would be unable to determine if it was revealing all required information if materiality were the only prerequisite for disclosure. If Oxford's position were adopted, issuers likely would overcompensate to avoid uncertain liability. As the Eleventh Circuit observed, such a result "'is hardly conducive to informed decisionmaking,'" because it would bury the shareholders "'in an avalanche of trivial information.'" App. 12 (quoting *Basic, Inc. v. Levinson*, 485 U.S. 224, 231 (1988)).

2. Lifting dicta from a footnote in *Kronfeld v. Trans World Airlines, Inc.*, 832 F.2d 726 (2d Cir. 1987), Oxford attempts to manufacture a conflict between the Eleventh Circuit's "duty to disclose" ruling and the law of the Second Circuit. *See* Petition at 18. The Eleventh Circuit's decision in this case, however, is consistent with the holding of *Kronfeld* and the other Second Circuit decision cited by Oxford, *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259 (2d Cir. 1993).

Oxford's "strict liability" argument mistakenly relies on footnote 8 in the *Kronfeld* decision and this Court's opinion in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983). The footnote in *Kronfeld* contained only dicta regarding whether the duty to disclose should be considered before or after the issue of materiality. The footnote made clear that the *Kronfeld* decision did not turn on this question because the Second Circuit assumed that the district court held that the alleged omissions were immaterial as a matter of law. *Kronfeld*, 832 F.2d at 730 n.8. Although the footnote cited *Huddleston*, the point of *Huddleston* was that § 11 claims do not require proof of scienter. 459 U.S. at 382. The *Huddleston* decision did not hold that § 11 liability could be based on a prospectus'

omission of an allegedly material fact when the omitted information was not "required to be stated therein or necessary to make the statements therein not misleading."

Moreover, the actual holding of the *Kronfeld* court is entirely consistent with the Eleventh Circuit's decision in this case. In *Kronfeld*, stock purchasers brought § 11 and § 10(b) claims against a parent company and its subsidiary, an issuer of stock, for failing to disclose material information in the prospectus describing a preferred stock offering. The stock purchasers claimed that the prospectus was misleading because, although it explained the relationship between the parent and subsidiary, it failed to disclose that the parent had hired an investment banking firm to explore strategic alternatives for the subsidiary and to explain the contemplated alternatives.

In determining whether the district court properly granted summary judgment on § 11 and § 10(b) claims, the Second Circuit found the partial disclosure of the issuer's relationship with its parent company was arguably misleading because it "did not give any fair indication of the equally substantial possibility that [the subsidiary's status] might be terminated." *Id.* at 736. Thus, in reversing summary judgment in favor of the defendants, the Second Circuit applied the well-settled principle of securities law that defendants have a duty to disclose any material facts that are necessary to make disclosures in a prospectus, whether mandatory or voluntary, not misleading.

Contrary to Oxford's suggestion, *Kronfeld* did not hold "that a finding of materiality ends the inquiry and necessarily subjects the non-disclosing issuer to strict liability." *See* Petition at 17. The *Kronfeld* court expressly disclaimed

a ruling on that issue. *Kronfeld*, 832 F.2d at 732 ("[W]e do not address here a pure question of a duty to disclose."). Instead, the Second Circuit framed the issue as whether the prospectus "omitted to state material facts necessary to make the statement therein not misleading; not whether, considered in the abstract, there was an obligation to disclose those facts at that time." *Id.* at 735. Subsequently, the Second Circuit confirmed that *Kronfeld* stands only for the proposition that the defendants had a duty to disclose material facts that were necessary to make statements in the prospectus at issue not misleading. *See Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 183 (2d Cir. 2001).

In the *Oxford* decision, the Eleventh Circuit embraced the same rule applied by the Second Circuit in *Kronfeld*: there is a duty to disclose material facts necessary to make statements in the prospectus not misleading. The Eleventh Circuit affirmed the dismissal in this case because the omission of the allegedly material prescription data did not render the prospectus misleading in light of the abundant and detailed cautionary statements contained in the prospectus regarding Niaspan®'s preliminary market acceptance:

> We conclude that the prospectus thoroughly explained the risks involved in marketing Niaspan, and specifically warned that Niaspan might have a slow start. . . . In view of all of this, the *six* weeks of prescription data, which represents only a *very preliminary* indication that Niaspan was starting slowly, did not have to be included in the prospectus. Such indication did not render materially misleading the prospectus's treatment of the market acceptance of Niaspan as an uncertainty.

App. 16 (emphasis in original). Nothing in the opinion below conflicts with the Kronfeld decision.

Similarly, there is no conflict between the Oxford decision and the Second Circuit's opinion in *Time Warner*. In analyzing the duty to disclose and materiality elements in the context of a § 10(b) claim, the *Time Warner* court stated that "a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact. Rather, an omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts." *Time Warner*, 9 F.3d at 267. The Second Circuit noted that the duty to disclose and materiality elements merge only "where the disclosure duty arises from the combination of a prior statement and a subsequent event, which, if not disclosed, renders the prior statement false or misleading." *Id.* In *Time Warner*, the Second Circuit thus held that the defendants were under a duty to disclose because the omitted information was necessary to make the prior statements not misleading.

The Eleventh Circuit's "duty to disclose" ruling aligns perfectly with the reasoning of the *Time Warner* decision. The mere fact that an investor arguably might have liked to have the preliminary prescription data did not create a duty to disclose because the securities laws did not require disclosure of this type of information, and the omission of the data did not make statements in the prospectus misleading. App. 12. Oxford's attempt to create a conflict between the law of the Second Circuit and the decision below fails. There is no need for this Court to review the Eleventh Circuit's well reasoned "duty to disclose" ruling.

III. THE SANCTIONS AWARD REFLECTS THE PROPER EXERCISE OF DISCRETION BASED ON FACTUAL FINDINGS WHICH ARE NOT APPROPRIATE FOR REVIEW BY WRIT OF CERTIORARI

The sanctions award is a good example of the sort of fact-based, discretionary ruling that is not appropriate for review by writ of certiorari. The district court did not impose sanctions lightly. Rather, it did so only after affording Oxford oral argument on the motion to dismiss and allowing Oxford to oppose the sanctions motion with expert testimony. The district court awarded sanctions because, even after consulting with experts, Oxford was unable to present the court with a factual basis for its claims. App. 67 n.5.

The district court observed that the studies identified in the complaint did not support Oxford's "efficacy" claims because they were consistent with the prospectus' statements regarding Niaspan®'s efficacy. App. 69. The court also noted that at oral argument on the motion to dismiss, "Plaintiffs conceded that it was 'very possible' that Defendants were 'right' about the figures cited in the Prospectus." *Id.*

When it dismissed the "safety" claims, the court found that Oxford presented only conclusory allegations of misrepresentations, and did not challenge or contradict any of the FDA-approved studies or results. App. 59. The sanctions order again noted this failure, and that the disclosures in the prospectus negated the allegation that Kos misrepresented "flushing" data. App. 70. At oral argument on the motion to dismiss, the only basis given by Oxford for its "intolerability" claim was "that there must be some reason 'why physicians don't prescribe it.'" App.

19. The district court found that Plaintiffs' inability to offer any facts or explanation for this claim further supported the sanctions award. App. 70.

The district court also held that the very portion of the prospectus cited by Oxford in support of its claim that Kos' $1.5 million in sales to wholesalers was misleading "demonstrates that this claim, too, was not well grounded in fact." App. 71. The prospectus clearly indicated that the $1.5 million sales volume related to shipments to wholesalers, not sales to physicians. *Id.* In light of these disclosures, the sales claim, like the others, was objectively frivolous. In sum, the district court imposed sanctions because, as reflected in the order granting the motion to dismiss, "Plaintiffs' counsel has indicated that there is no further information that could be gathered to further specify the allegations of this Complaint" without, as the district court put it, "fishing expeditions." App. 43, 59.

The Eleventh Circuit did not "rubber stamp" the district court's findings on the sanctions issue. The Eleventh Circuit affirmed the bulk of the sanctions award, but it did reverse the sanctions award with respect to one claim that was added late in the case. The Eleventh Circuit concluded that sanctions should not be awarded for bringing this claim because "[t]his argument, though ultimately rejected, was not frivolous." App. 22.

Rule 10 of the Rules of the Supreme Court advises that fact-specific findings such as those that support the sanctions award in this case are not appropriate for review on writ of certiorari. Oxford cannot escape this necessary approach to certiorari by claiming that the legal issues in this case were "unsettled" prior to the Eleventh Circuit's decision. As shown above, the Eleventh Circuit used an

established pleading standard when it affirmed the dismissal. Moreover, the "duty to disclose" ruling is not novel, considering that it tracks the language of § 11 and is consistent with the decisions of other circuits. The Court, therefore, should deny the petition with respect to the third question presented by Oxford because the sanctions award is purely a fact-based decision that is not appropriate for review by this Court.

CONCLUSION

The Court should deny the petition for writ of certiorari.

Respectfully submitted,

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No. 03-2

In the Supreme Court of the United States

OXFORD ASSET MANAGEMENT, LTD.,
and SUSMAN & WATKINS,
Petitioners,

v.

MICHAEL JAHARIS, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF FOR UNDERWRITER RESPONDENTS IN OPPOSITION

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25 pp

QUESTIONS PRESENTED

1. Whether a complaint may be dismissed under Rule 8 of the Federal Rules of Civil Procedure on the ground that it pleads only conclusions that are based on unwarranted deductions of facts or that are contradicted by the documents attached to or relied upon in the complaint.

2. Whether Section 11 of the Securities Act of 1933 should be interpreted in accordance with its plain terms to give rise to a cause of action based on an allegedly material omission only when the omitted facts (a) were required to be disclosed in the registration statement by SEC regulations or (b) were necessary to make what was actually said in the registration statement not misleading.

3. Whether it is an abuse of discretion for a district court to sanction a plaintiff and its counsel in a case brought under Section 11 based on its conclusion that the allegations of material misrepresentations in the complaint were "objectively frivolous."

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Respondent SG Cowen Securities Corp. is wholly owned by SG Americas, Inc. SG Americas, Inc. is wholly owned by Societe Generale, which is a publicly traded company. No other publicly-held company owns 10% or more of respondent SG Cowen Securities Corp.'s stock.

Respondent Salomon Smith Barney Holdings, Inc. is now known as Citigroup Global Markets Holdings Inc. Citigroup Global Markets Holdings Inc. is wholly owned by Citigroup Inc., which is a publicly traded company. No other publicly-held company owns 10% or more of respondent Salomon Smith Barney Holdings, Inc.'s stock.

Respondent Warburg Dillon Read, L.L.C. is now known as UBS Securities LLC. UBS Securities LLC is wholly owned, directly and indirectly, by UBS AG, which is a publicly traded company. No other publicly-held company owns 10% or more of respondent Warburg Dillon Read, L.L.C.'s stock.

Respondent Donaldson, Lufkin & Jenrette is now known as Credit Suisse First Boston LLC. Credit Suisse First Boston LLC is wholly owned by Credit Suisse First Boston (USA), Inc. Credit Suisse First Boston (USA), Inc. is indirectly owned by Credit Suisse Group, which is a publicly traded company. No other publicly-held company owns 10% or more of respondent Donaldson, Lufkin & Jenrette's stock.

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Statutes and Regulations:

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BRIEF FOR UNDERWRITER RESPONDENTS IN OPPOSITION

This brief is submitted by the underwriters who were named as defendants in the Section 11 and Section 12(a)(2) claims brought by plaintiff-petitioner Oxford Asset Management, Ltd.: SG Cowen Securities Corp., Donaldson Lufkin & Jenrette, Salomon Smith Barney Holdings, Inc., and Warburg Dillon Read, L.L.C. (referred to collectively herein as the "Underwriter Respondents").

STATEMENT

Petitioners' Statement contains a number of misstatements of fact — about what was said in the Prospectus at issue here, about what was pleaded in petitioners' own complaint, and about the basis of the Eleventh Circuit's decision affirming the dismissal of the complaint and the imposition of sanctions. When those misstatements are stripped away, it becomes apparent that there is nothing in the decision below that warrants review by this Court.

A. The Prospectus.

Kos Pharmaceuticals, Inc. ("Kos") was founded in 1988 to develop and commercialize prescription drugs for the treatment of certain chronic cardiovascular and respiratory diseases. Prospectus, Ex. A to Complaint, C.A. App. D, at 3-4. The Company successfully completed an initial public offering of stock in March 1997, before it had received FDA approval to market any drug. *Id.* at 18. On July 28, 1997, the Company was granted clearance by the FDA to market its first drug, Niaspan®. *Id.* at 3. On October 24, 1997, Kos and two of its founding shareholders completed a second public offering of Kos stock underwritten by the Underwriter Respondents. Complt. ¶ 2. It is the prospectus for that public offering (the "Prospectus") that is at issue in this case.

Niaspan® is a once-a-day, controlled release formulation of niacin, which is a water soluble vitamin. Prospectus at 22. Niacin has long been recognized as an effective agent in reducing "bad" cholesterol and increasing "good" cholesterol in patients with heart disease. *Id.* at 23. However, niacin's adverse side effects prevented it from becoming widely accepted. Niacin frequently caused patients to suffer intolerable "flushing," in the form of facial redness and tingling, often accompanied by a rash. *Id.* at 24. Niacin also was associated with a high incidence of liver toxicity. *Ibid.* Niaspan® was designed to minimize these side effects, while at the same time effectively treating patients' cholesterol problems. *Id.* at 23, 24.

The Prospectus summarized the test data concerning efficacy, safety and tolerability that the Company had submitted to the FDA to obtain approval for Niaspan®. Among other things, the Prospectus reported study results showing that patients taking Niaspan® experienced a significantly lower incidence of the side effects that previously had prevented widespread acceptance of niacin. Nevertheless, the Prospectus warned investors that patients' actual experience with Niaspan® could differ from the test results and that there was a risk that doctors who had had bad experiences with niacin in the past might be reluctant to prescribe Niaspan®:

> The Company believes that intolerable flushing is a principal reason why physicians generally have been reluctant to prescribe or recommend currently available formulations of niacin. . . . Although most patients taking Niaspan® will sometimes flush, the formulation and dosing regimen for Niaspan® have been designed to maximize patient acceptance and minimize the occurrence of flushing. *There can be no assurance, however, that patients using Niaspan® will not suffer episodes of flushing that they consider intolerable. The failure of physicians*

> *to prescribe Niaspan® or the failure of patients to continue taking Niaspan® due to intolerable flushing or to other side effects would have a material adverse effect on the Company.* The Company believes that physicians have also been reluctant to prescribe or recommend certain currently available formulations of niacin because of potential liver toxicity associated with these formulations. Although clinical trials conducted using Niaspan® demonstrated that fewer than 1% of patients experienced clinically significant elevations in liver enzyme levels, *there can be no assurance that patients using Niaspan® in actual practice will not experience clinically significant elevations of liver enzymes or other side effects at a rate higher than those experienced in the Company's clinical trials.*

Prospectus at 6 (emphasis added).

The Prospectus also warned that Kos' "marketing experience to date is limited," that the Company had a smaller sales force than its competitors, and that there could be no assurance that its sales force would be able to successfully market the product to physicians who prescribe lipid-altering medications. Prospectus at 8-9. The Prospectus noted that there were many commercially available products for the treatment of elevated LDL cholesterol (and others under development) and that the manufacturers of those products had greater financial resources, sales, and manufacturing capabilities than Kos. *Id.* at 9. Thus, even if Niaspan® turned out to be a superior product, the Prospectus warned that other entities might be more successful in marketing their competing products. *Ibid.*

The Prospectus did not contain any optimistic predictions about likely future sales of Niaspan®. On the contrary, it

warned that sales of Niaspan® were likely to get off to a slow start. The Prospectus explained that the Company's strategy was to provide complimentary three-week starter packs of Niaspan® for physicians to give their patients, in the hope that the physicians would then begin to write prescriptions for Niaspan®. Because of the significant marketing challenges confronting the Company and the three-week trial offer, the Prospectus cautioned investors that it was likely that, after the initial product launch, prescription sales of Niaspan® would increase only "modestly":

> As part of the Company's detailing effort, three-week Niaspan® titration starter packs are given to physicians as a promotional item to start their patients on Niaspan®. These titration packs generally are dispensed without a prescription. Further, physicians being detailed by the Company may have had unsatisfactory experiences with currently available generic formulations of niacin, the active ingredient in Niaspan®. The Company believes, therefore, that during the initial months following the launch of Niaspan®, many physicians may start only a limited number of selected patients on Niaspan® in order to confirm its efficacy, safety, and tolerability. Consequently the Company believes that during this three-to-six month period, prescriptions for Niaspan® are likely to increase modestly.

Prospectus at 25-26.

Contrary to the assertion in the petition (at 4), the Prospectus did *not* contain any estimate of future earnings — let alone an estimate based on the assumption that 5000 prescriptions would be written within the first eight weeks after Niaspan® was launched. In fact, the Prospectus made it clear that Kos had consistently lost money while it was in its development stage (reporting losses of $11, $21 and $23

million in 1995, 1996 and 1997, respectively) and that it expected to continue sustaining significant losses for at least six months and possibly longer after the marketing of Niaspan® had begun:

> The Company expects to incur significant operating losses for at least the next six months, primarily due to continued investments in its research and development programs and for manufacturing and marketing, sales and administrative expenses associated with the launch of Niaspan®. *No assurance can be given that additional significant losses will not continue thereafter.*

Prospectus at 6 (emphasis added).

Although Kos did not make any earnings estimate in the Prospectus, the market was no doubt aware of a revenue forecast that was independently made by Robert Uhl, who was an analyst for Salomon Smith Barney. Before the launch, Mr. Uhl predicted that Niaspan® sales would be $12 million for 1997 and $92 million for 1998. C.A. App. F, at 2. However, the Prospectus did not even mention — let alone purport to endorse — Mr. Uhl's prediction. Indeed, the information in the Prospectus made it clear that Kos had a long way to go to achieve the level of sales Mr. Uhl had predicted. For the quarter ending September 30, 1997, which included the first six weeks Niaspan® had been on the market, the Prospectus estimated that Kos had achieved revenues of only $1.5 million as a result of sales of Niaspan® to wholesalers — leaving it $10.5 million shy of Mr. Uhl's predicted revenue target, with only one quarter left to go. Prospectus at 18.[1]

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[1] Under SEC Regulations, the Prospectus was not required to include this kind of quarterly financial information. Because Kos included in the Prospectus its audited financial statements as of the

The public offering closed on October 21, 1997. Approximately three weeks later, on November 12, 1997, Mr. Uhl issued another report in which he cut in half his revenue predictions for sales of Niaspan® for the remainder of 1997 through 2000 and downgraded Kos' stock from a "buy" to a "hold." The petition states that Mr. Uhl revised his previous prediction based on "the first eight weeks of prescription data," which is "generally considered to be a reliable indicator of future commercial performance." Pet. 4. But, as the Uhl report, the complaint, and the opinions below all make clear, Mr. Uhl's prediction was based not on eight weeks' worth of prescription data, but rather on data concerning the level of sales in the *eighth week* after Niaspan® went on the market. C.A. App. F, at 2-3, Pet. App. 3, 51. It is undisputed that the eighth week ended on October 31, 1999 — ten days *after* the public offering was completed. Pet. 4.

Significantly, nowhere in his November 1997 report did Mr. Uhl suggest that there was any problem with Niaspan® from the standpoint of safety or effectiveness; nor did he question the commercial viability of the drug. On the contrary, Mr. Uhl stated that "[e]ventually we are confident that Niaspan® will find its place in the market, but it appears that the initial acceptance will take longer and be slower than [we] originally expected."[2] C.A. App. F, at 4.

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close of its fiscal year on June 30, 1997, it could have avoided any disclosure of its relatively meager sales to wholesalers through the end of September. See Regulation S-X, Rule 3-12, 17 CFR § 210.3-12 (updated financial statements are required only if the company's annual financial statements are more than 135 days old). By voluntarily including this information in the Prospectus, Kos conveyed yet another cautionary message to potential investors.

[2] Echoing some of the risk factors outlined in the Prospectus, Mr. Uhl attributed some of the slowness in the growth of prescriptions to

Following the issuance of Mr. Uhl's revised recommendation, the market price of Kos stock fell sharply, prompting this lawsuit.

B. Proceedings Below.

On August 10, 1998, plaintiff filed this lawsuit, alleging that the Prospectus was materially misleading in a number of respects in violation of Sections 11 and 12(a)(2) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934. Plaintiff sought damages against the Company, its officers and directors, and the underwriters of the offering on behalf of a purported class of purchasers of Kos stock under both state and federal law. Plaintiff did not accuse the Underwriter Respondents of engaging in deliberate fraud; instead, the only federal claims asserted against the Underwriter Respondents were claims under Sections 11 and 12(a)(2).

Throughout the proceedings in the lower courts, petitioners continually changed the theories they offered in support of their claim that the Prospectus was materially false or misleading. In fact, it was not until oral argument on the motion to dismiss that petitioners first raised the theory that was the centerpiece of their appeal to the Eleventh Circuit — that the defendants had violated a claimed duty to disclose information about the first six weeks' worth of prescription sales of Niaspan®. See Pet. App. 49 & n.21. Although the district court recognized that this claim was untimely, it nevertheless chose to review its sufficiency "in the interests of justice." *Ibid.*

In their petition, petitioners continue to focus on their omission claim as well as on two claims aimed at allegedly

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Kos' "relatively small" sales force, as well as to a lag in filling prescriptions that was produced by Kos' program of providing free three-week samples to physicians. C.A. App. F, at 2.

false or misleading statements in the Prospectus — all of which the lower courts found to be insufficient as a matter of law.

1. At page 5 of their petition, petitioners assert that prescription information from the first six weeks' worth of Niaspan® sales should have been disclosed in the Prospectus because it would have shown "that the level of Niaspan prescriptions could not support the prospectus' earnings estimates." This description, however, misstates petitioners' own claim. The Prospectus did not include any earnings estimates. Accordingly, petitioners never argued in the lower courts that prescription sales data was necessary to counterbalance such estimates.

Instead, petitioners' argument was that even a few weeks' worth of prescription information would have been material to a reasonable investor because it was information about weak prescription sales that caused the market price of Kos stock to drop sharply after the offering was completed. The district court rejected this argument. It noted that the "materiality of this information is highly questionable, if not absent" in light of the many cautionary statements in the Prospectus about the considerable risks Kos faced in marketing Niaspan®. Pet. App. 51. Moreover, the "relevant week . . . the analyst considered it reasonable to rely on" in changing his prediction of Kos' future revenues — the eighth week of sales — had "not even occurred when the Prospectus was filed and the Offering held." *Ibid.*

On appeal, the Eleventh Circuit affirmed. Although it recognized that the materiality of the information was marginal at best, the court assumed for purposes of argument that whatever information Kos may have had about prescription sales would have been material to a reasonable investor. The court nevertheless concluded that there was no duty to disclose the information because SEC regulations did not require this kind of data to be disclosed and because the failure to disclose

it did not render any statement that was made in the Prospectus materially misleading. Pet. App.12-16. The court rejected petitioners' argument that Section 11 imposes a general duty to disclose *all* material information in a registration statement, citing the plain language of Section 11, which creates a right of action for an omission in a registration statement only if it "omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading." *Id.* at 11-12.

2. Petitioners' second claim is that the Prospectus misrepresented Niaspan®'s efficacy by stating that it could boost "good" HDL cholesterol "by up to 32%." In the complaint, petitioners explained why they believed this statement was false, pointing to the fact that a July 1997 Kos press release and a 1996 article discussing a clinical trial of Niaspan® revealed an upper range of results that was lower than 32%.

In concluding that the complaint failed to state a claim for falsity on this point, the district court noted that there was nothing in the prior press release or article that contradicted the 32% claim in the Prospectus: the results reported in Kos' prior statements fell within the range of results reported in the Prospectus. Pet. App. 43. Moreover, both the Prospectus and the FDA-approved package insert for Niaspan® made it clear that they included new test results from *additional* studies that had not been reported either in the July 1997 press release or the 1996 article. *Ibid.*[3] At oral argument on the motion to

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[3] As defendants pointed out in the court below, the FDA-approved package insert contains a table that shows a mean increase in HDL of 32% — exactly the figure reported in the Prospectus as the high end of the range of mean increases reported in the various tests. C.A. R. 77, at 11. In this Court, petitioners do not challenge the propriety of the district court's decision to take judicial notice of the package

dismiss, plaintiffs' counsel acknowledged that the existence of these additional studies might well explain the differences between the Prospectus and Kos' earlier statements, stating that "it was 'very possible' that Defendants are 'right' about these figures." Pet. App. 43. The district court was unimpressed by petitioners' argument that they nevertheless were entitled to discovery because the truth of the statements made in the Prospectus "could not be confirmed" without a review of the additional studies. *Ibid.* The district court held, and the court of appeals agreed, that even under Rule 8's notice pleading requirements, a mere "suspicion (or less)" that plaintiffs "might have a basis for a claim" was not enough to avoid a motion to dismiss. *Ibid.*

3. Petitioners describe their third claim as alleging that the Prospectus was materially misleading because it failed to disclose that Niaspan® was supposedly "intolerable" at the effective dose of 2000 mg and because Kos allegedly based its "safety claims on defective clinical trials that excluded pre-menopausal women, who have lower tolerances to the drug's side effects." Pet. 6. This was not the claim that petitioners asserted in their complaint and litigated in the district court, however. Instead, the complaint alleged that only a "tiny fraction" of the potential market for Niaspan® could tolerate its side effects and that the studies described in the Prospectus, which indicated that a 2000 mg dose was in fact tolerable, "were 'rigged' to include only those individuals who had an unusually high tolerance." Pet. App. 46. Petitioners never suggested in their complaint or their arguments on the motion to dismiss that the studies in question were "rigged" because they improperly excluded pre-menopausal women. On the contrary, as the district court noted, plaintiffs' counsel was

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insert and other documents cited in the complaint. *See* Pet. App. 7-8, 39.

unable to offer any explanation as to why he thought the tests showing that a 2000 mg dose was tolerable were "rigged" other than to say that "there has to be some reason 'why physicians don't prescribe it.'" Pet. App. 47.[4]

The district court concluded that this claim also failed as a matter of law because plaintiffs had admitted that they had no factual basis for believing that any of the clinical tests described in the Prospectus had been "rigged." Because the test data, which had been presented to and relied upon by the FDA when it approved Niaspan®, contradicted plaintiffs' claim that only a "tiny fraction" of the population could tolerate a 2000 mg dose, the court concluded that the complaint failed to properly plead falsity on this theory as well. On appeal, the Eleventh Circuit agreed with this analysis. Pet. App. 19.

Contrary to the characterization in the petition, neither the district court nor the Eleventh Circuit purported to be applying a heightened pleading standard to plaintiffs' 1933 Act claims. Nor did they suggest that the Private Securities Litigation Reform Act ("PSLRA") had somehow altered the pleading standards for a motion to dismiss a 1933 Act claim. Instead, both courts explicitly stated that they were granting the defendants' motions to dismiss for failure to state a claim under Rule 8. Pet. App. 7, 35-37.

After their motions to dismiss were granted, the defendants filed motions for sanctions under Rule 11. After briefing and argument, the district court granted those motions, on the ground that plaintiffs should have realized, once they had completed their pre-filing investigation, that they had no factual basis for bringing any of the claims alleged in their complaint.

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[4] It was not until the defendants filed a motion for sanctions that plaintiffs first advanced the claim that the studies were "rigged" because they excluded pre-menopausal women.

The district court held that the claims asserted in the complaint were "objectively frivolous" and that petitioners had "demonstrated a deliberate indifference to their lack of factual support." Pet. App. 68. On appeal, the Eleventh Circuit largely agreed, holding that the only claim for which petitioners had any factual support – and the only one that was therefore not sanctionable – was the claim that the Prospectus should have included preliminary prescription data. Pet. App. 22.

REASONS FOR DENYING THE PETITION

The petition should be denied because the circuit conflicts petitioners rely upon either do not exist or are not implicated by the decision in this case. *First*, contrary to petitioners' argument, the courts below did not purport to apply or in fact apply a heightened pleading standard to petitioners' 1933 Act claims. Instead, the lower courts simply applied well-settled pleading rules to the specific facts alleged in this case. As a result, there is no conflict between the decision in this case and decisions in other circuits on the question of whether 1933 Act claims that "sound in fraud" should be subject to the heightened pleading requirements of Rule 9(b). Nor is there any issue of general importance for this Court to consider. Whether the lower courts' analysis of the specific allegations of the complaint was correct is an utterly fact-bound issue that plainly does not warrant this Court's review.

Second, the Eleventh Circuit's conclusion that there was no duty to disclose prescription information even if that information were deemed to be material does not create a conflict with the Second Circuit, as petitioners contend. Nor is it based on an erroneous construction of Section 11. The Eleventh Circuit read Section 11 just as it is written, to prohibit omissions of material facts that are either "required to be stated" in the registration statement or are "necessary to make the statements" that were made in that document "not

misleading." Petitioners do not challenge the court of appeals' conclusion that defendants were not required to disclose the prescription data by any SEC regulations. Nor do they contend that the court below erred in concluding that disclosure of the prescription data was not necessary to ensure that statements actually made in the Prospectus were not misleading. Under those circumstances, there is no textual or policy basis for imposing liability under Section 11 for the omission — even if the facts in question could be deemed material.

Finally, the imposition of sanctions does not provide a basis for review by this Court. Petitioners' argument that they were improperly sanctioned is based entirely on their claim that the courts below improperly imposed a heightened pleading burden on them. That argument fails not only because the lower courts did not in fact impose a heightened pleading burden on petitioners but also because the district court did not sanction them for failing to meet their pleading burden. Rather, the sanctions order was based on the court's conclusion that the information petitioners gathered in the course of their pre-filing investigation demonstrated that their claims were "objectively frivolous." Whether that conclusion was an abuse of discretion is a fact-intensive determination that has already been thoroughly vetted by the court of appeals and does not merit this Court's attention.

I. This Case Does Not Raise The First Question Presented By The Petition Because The Lower Courts Did Not Apply A "Fact Pleading" Standard To Petitioners' 1933 Act Claims.

Petitioners are right that there are differences among the circuits on the question of whether the heightened pleading requirements of Rule 9(b) apply to claims brought under the 1933 Act when those claims "sound in fraud." But those differences are irrelevant to this case because the Eleventh

Circuit did not purport to decide whether a heightened pleading standard should ever be applied to a 1933 Act claim. Indeed, the Eleventh Circuit had no occasion to decide that issue because it concluded that the complaint failed to state a claim even under the more relaxed pleading standards of Rule 8.[5]

Despite the fact that the Eleventh Circuit did not purport to be applying a heightened pleading standard, petitioners contend that it in fact did so. In support of that argument, petitioners cite passages from the opinions below in which the courts stated that petitioners had failed to offer any factual basis for their conclusory assertions of falsity. But those passages do not suggest that the courts were departing from the requirements of Rule 8.

Although the "demands on the pleader [under Rule 8] are minimal," they "are not tantamount to nonexistent requirements." *Cooperman v. Individual, Inc.*, 171 F.3d 43, 47 (1st Cir. 1999). It is well-settled that even under Rule 8 a court ruling on a motion to dismiss should ignore conclusory allegations, unwarranted inferences, claims that are internally inconsistent, and allegations that mischaracterize or conflict with documents cited or relied upon in the complaint. *See, e.g., South Florida Water Management Dist. v. Montalvo*, 84 F.3d 402, 408 n.10 (11th Cir. 1996) ("conclusory allegations and unwarranted deductions of fact are not admitted as true in a motion to dismiss"); *In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1403 (9th Cir. 1996) ("conclusory allegations of law and unwarranted inferences are insufficient to defeat a motion to dismiss for failure to state a claim"); *Shaw v. Digital Equipment*

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[5] Defendants argued that plaintiffs' claims sounded in fraud – particularly their claim that Kos had "rigged" its clinical trials – and that Rule 9(b) should therefore be applied in judging the adequacy of their allegations. But the lower courts found it unnecessary to reach that issue.

Corp., 82 F.3d 1194, 1216 (1st Cir. 1996) (in "deciding a motion to dismiss under Rule 12(b)(6), a court must take all well-pleaded facts as true, but it need not credit a complaint's 'bald assertions' or legal conclusions").

The lower courts properly applied these unremarkable pleading rules to the particular facts of this case. Petitioners' own allegations demonstrated that their conclusion that the Prospectus misrepresented Niaspan®'s ability to increase "good" cholesterol was an "unwarranted inference" drawn from only partial information. As noted above, petitioners themselves explained that their claim that the 32% figure was false was based entirely on the fact that lower figures had appeared in an earlier press release and article. But the Prospectus itself and other documents that the court could properly consider on a motion to dismiss showed that those earlier statements were based on a smaller number of clinical studies than the information in the Prospectus. Thus, the discrepancy petitioners relied upon was easily explained and cannot provide a basis for claiming that the results set forth in the Prospectus were misrepresented.

The same analysis applies to the other falsity argument petitioners continue to press in this Court. In their complaint, petitioners alleged that Niaspan® would never be commercially viable because only a "tiny fraction" of the population could tolerate its side effects at the 2000 mg dose level required for efficacy. This wholly unsupported assertion, however, was directly contradicted by the clinical studies reported in the Prospectus showing that 2000 mg doses were well tolerated. In order to support their assertion of falsity, petitioners alleged that the clinical studies had been "rigged." But in arguing the motion to dismiss, petitioners were never able to explain *how* they were supposedly "rigged." Indeed, at oral argument on the motion, plaintiffs' counsel essentially admitted that this assertion was a shot in the dark. In light of that admission, the

district court was clearly not required to credit plaintiffs' conclusory allegations of misconduct in ruling on the motion to dismiss.

In their petition, petitioners advance a theory they first raised in response to defendants' motion for sanctions — that the test results on tolerability were skewed because pre-menopausal women were left out of the study. Even assuming that the studies included only men and post-menopausal women, however, that would not support the conclusory assertions in the complaint. Plaintiffs alleged that only a "tiny fraction" of the population could tolerate a 2000 mg dose of Niaspan® (Pet. App. 46) — a description that hardly fits the entire male population and the portion of the female population that is most likely to take a cholesterol-lowering medication.

In any event, whether or not the lower courts properly evaluated the allegations of the complaint under the well-established standards of Rule 8 is clearly not an issue warranting this Court's review.

II. The Eleventh Circuit's Conclusion That There Was No Duty To Disclose Prescription Data Does Not Create A Conflict.

Section 11 does not purport to create a duty to disclose all material information. Instead, it requires disclosure of material information that is "required to be stated" in the registration statement or that is "necessary to make the statements" that are actually made in the registration statement "not misleading."[6] In this case, the Eleventh Circuit carefully considered and rejected petitioners' argument (raised for the first time in their

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[6] By contrast, Section 12 — like Section 10(b) of the 1934 Act — imposes an obligation only to disclose material information that is necessary to make whatever was actually said not misleading.

reply brief on appeal) that Item 303 of SEC Regulation S-K required disclosure of whatever prescription data could have been obtained by the time the Registration Statement became effective. Pet. App. 12-15. The Court also rejected the argument that disclosure of the prescription data was necessary so that statements made in the Prospectus would not be misleading. *Id.* at 16. Petitioners do not challenge either conclusion.

Instead, petitioners argue that Section 11 imposes strict liability on an issuer and negligence liability on underwriters if they fail to disclose information that a court later finds to be material — even if no SEC regulation required it to be disclosed and even if it is not necessary to ensure that statements made in the registration statement are not misleading.

Petitioners contend that a footnote in the Second Circuit's decision in *Kronfeld v. Trans World Airlines, Inc.*, 832 F.2d 726, 730 n.8 (2d Cir. 1987), supports their position and that the Eleventh Circuit's decision in this case creates a split in the circuits. As the Second Circuit specifically recognized in *Kronfeld*, however, that case did not involve the "pure question of a duty to disclose" presented by this case. *Id.* at 732. Instead, the issue in *Kronfeld* was whether the prospectus "omitted to state material facts necessary to make the statements therein not misleading." *Id.* at 735. Under these circumstances, whatever the Second Circuit may have said in a footnote about the breadth of disclosure obligations under Section 11 was clearly dicta.

Furthermore, since *Kronfeld*, the lower courts — including district courts in the Second Circuit — have consistently agreed with the approach the Eleventh Circuit took in this case. *See, e.g., Cooperman v. Individual, Inc.*, 171 F.3d at 49 (there is "no absolute duty to disclose all material information" in a prospectus); *In re Sofamor Danek Group, Inc.*, 123 F.3d 394, 400 (6th Cir. 1997) ("Materiality alone is not sufficient to place

a company under a duty of disclosure"); *Milman v. Box Hill Sys. Corp.*, 72 F. Supp. 2d 220, 227 (S.D.N.Y. 1999) ("to maintain a claim for failure to disclose information pursuant to § 11, a plaintiff must demonstrate both that the defendant had an affirmative duty to disclose the information and that the information was material").

Recently, in *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 2003 U.S. Dist. LEXIS 11113, at *10-12 (S.D.N.Y. July 2, 2003), the court followed the Eleventh Circuit's decision in this case, citing it (and a number of cases decided in the Southern District of New York) for the proposition that "[t]o state a claim under Sections 11 and 12(a)(2) [based on an omission], a plaintiff must allege that the defendants had a legal obligation to disclose the allegedly omitted information" — that is, plaintiffs must point to an "SEC regulation or other legal authority" that would require the disclosure of the information in question. *Accord Shaw v. Digital Equipment Corp.*, 82 F.3d at 1204 ("The information 'required to be stated' in a registration statement is spelled out both in Schedule A to Section 7(a) of the Securities Act, 15 U.S.C. §§ 77g(a), 77aa, and in various regulations promulgated by the SEC pursuant to its statutory authority").

Thus, there is no conflict or confusion among the lower courts with respect to the proper interpretation of Section 11 that requires this Court's intervention. Nor does the Eleventh Circuit's interpretation raise any important issues concerning the language or policies behind Section 11.

The Eleventh Circuit's interpretation of Section 11 is entirely consistent with its plain language. Section 11 does not impose liability for a failure to disclose "all material facts"; rather, it imposes liability for a failure to disclose "material fact[s] required to be stated" in a registration statement. As the Eleventh Circuit recognized, the interpretation petitioners urge

would render the phrase "required to be stated" completely superfluous. Pet. App. 11.

Furthermore, contrary to petitioners' argument, there is no policy reason for imposing Section 11 liability on issuers and underwriters for failure to disclose "material" information that SEC regulations do not require them to disclose. Materiality often lies in the eye of the beholder. And what appears to be material in the clear light of hindsight may not seem to be material at all at the time a prospectus is drafted. Imposing strict liability on issuers and negligence liability on underwriters under Section 11 for failing to disclose any information that a jury might later determine to be material would inevitably chill investment activity. As the Eleventh Circuit recognized, it would also force issuers and underwriters into a position where they would have no choice but to inundate investors with mountains of minutiae in each prospectus lest they later be accused of omitting some scrap of information that a disappointed investor claimed was material. Pet. App. 12 (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988), for the proposition that the securities laws should not be interpreted in ways that force issuers to bury investors in "an avalanche of trivial information").

III. The Imposition of Sanctions Does Not Raise Any Issue Warranting This Court's Review.

Petitioners contend that the district court sanctioned them for failing to meet a heightened pleading burden that was improperly applied to their 1933 Act claims. As demonstrated above, however, the courts below did not impose a heightened pleading burden on petitioners. Moreover, the district court did not sanction petitioners for their failure to meet the applicable pleading standards. Instead, it sanctioned them because their own arguments made it abundantly clear that they had filed their complaint without any factual basis for believing that

investors had been misled — precisely the kind of conduct Congress intended to curb when it enacted the PSLRA.

In any event, whether the district court abused its discretion in concluding that all but one of petitioners' claims were "objectively frivolous" is a fact-specific issue that plainly does not warrant this Court's review.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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In the
Supreme Court of the United States

OXFORD ASSET MANAGEMENT, LTD., and SUSMAN & WATKINS,

Petitioners,

v.

MICHAEL JAHARIS, DANIEL M. BELL, DUNCAN H. COCROFT, JUAN F. RODRIGUEZ, ROBERT E. BALDINI, JOHN BRADEMAS, STEVE JAHARIS, LOUIS LASAGNA, MARK NOVITCH, FREDERICK B. WHITTEMORE, KOS PHARMACEUTICALS, INC., COWEN & COMPANY, DONALDSON LUFKIN & JENRETTE, SALOMON SMITH BARNEY HOLDINGS, INC., SBC WARBURG, DILLON, READ, INC., individually and as representatives of THE CLASS OF UNDERWRITER DEFENDANTS,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

PETITIONERS' REPLY BRIEF

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The Petition should be granted for all of the reasons stated therein. For purposes of clarity, Petitioners respectfully submit the following limited response to the Underwriters' discussion of Oxford's material omission claim.

Oxford's claim in the district court was that: (a) Kos had approximately seven weeks of Niaspan prescription data at the time of the Secondary Offering (R.1, ¶ 53), (b) the data in Kos's possession indicated that Niaspan was not "a commercially viable product" (R.1, ¶ 61; R.57, pp. 8-9), which, in turn, showed that the Secondary Offering share price was unsupportable; and (c) Kos nonetheless failed to disclose that material data to the public at the time of the Secondary Offering.[1] Although that claim met the notice pleading standard of Fed. R. Civ. P. 8(a), Oxford provided additional factual detail as to the materiality of the omitted data, further pleading that: (1) an analyst for Salomon issued a report concluding that the Niaspan prescription data, almost all of which Kos possessed at the time of the Secondary Offering, showed that Niaspan was a commercial failure, and (2) once the adverse prescription data was disclosed by Salomon, the share price collapsed. (R.1 ¶¶ 52-53, 61; R.57, pp. 8-9.)

The Underwriters offer two fact-based attacks on Oxford's material omission claim. *First*, the Underwriters take Oxford to task for stating in its Petition that the omitted sales data undercut the Prospectus's "earnings estimates," pointing out that the Prospectus did not actually contain any "earnings estimates" *per se*. (Underwriters' Br. at 4.) Strictly speaking, the Underwriters are correct in

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[1] Respondents allege that Oxford did not raise its material omission theory until oral argument on their Motion to Dismiss. (*E.g.*, Underwriters' Br. at 7.) That is incorrect. In both its Complaint and its Response to Kos's Motion to Dismiss, Oxford alleged that Kos withheld material prescription data. (*E.g.*, R.1, ¶¶ 52-53, 61; R.57, pp. 8-9.)

criticizing the precise words which the Petition uses to describe Oxford's claim below. More accurately, Oxford argued below that the data omitted by Kos demonstrated that the *share price* for the Secondary Offering (which necessarily reflects Kos's estimate of future performance), rather than any express "earnings estimate," was unsupportable. However, the Underwriters' criticism of Oxford's word choice is beside the point. The Kos Prospectus unquestionably represented that its *only* product had commercial value. Yet, as Oxford properly pleaded, Kos knew otherwise before the closing of the Secondary Offering: Kos possessed via its own sales force, but did not disclose, seven weeks of material prescription data, showing that its sole product was a commercial failure. The Eleventh Circuit's decision to dismiss that claim—despite acknowledging the materiality of the omitted data—is both contrary to the Rule 8 pleading standard applicable to such claims and conflicts with the decisions of other circuits.

Second, Respondents quibble with Oxford's use of the Salomon Report. According to the Underwriters, the Salomon Report was an "independently" conducted analysis and Salomon's earnings estimates were not "endorsed" by the Prospectus. (Underwriters' Br. at 5.) Characterizing the Salomon Report as an "independent" analysis is not entirely accurate. After all, Salomon was a lead underwriter of Kos's Secondary Offering, was named as a defendant below, and is a respondent in this Court. At all events, Respondents' attempt to disassociate themselves from the Salomon Report is irrelevant and misstates Oxford's omission claim. Oxford's claim is not based on the Salomon Report, and it does not rise or fall on whether Kos disclosed Salomon's data or "endorsed" Salomon's revenue estimates. Rather, Oxford's claim against Kos is squarely based on *Kos's failure to disclose its own data*. The fact that one of the Respondents' own employees considered substantially the same data to be material, and that Kos's

share price collapsed as soon as that data was disclosed, merely provides factual support for Oxford's omission claim.

Respondents' discussion of Oxford's material omission claim and its use of the Salomon Report do not show that this case is inappropriate for review. Contrary to Respondents' assertions, review of the decision below does not require this Court to become entangled in any factual disputes. Rather, the Eleventh Circuit's decision squarely places before this Court the important, purely legal questions presented in Oxford's Petition.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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